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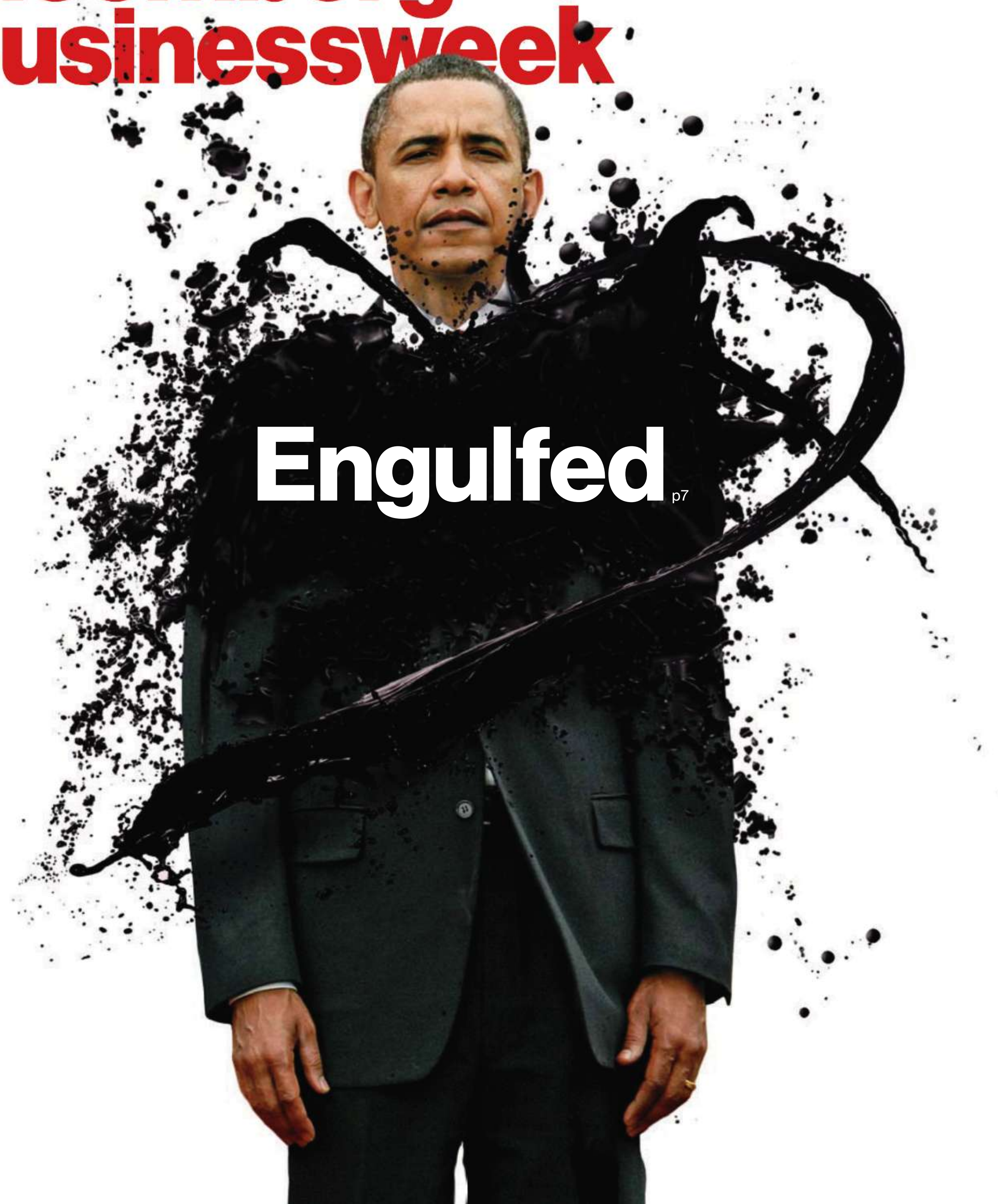
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Engulfed

p7

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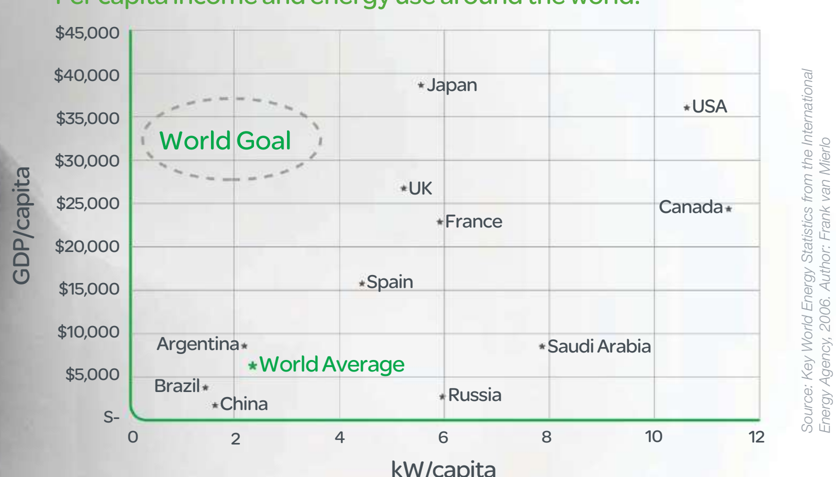
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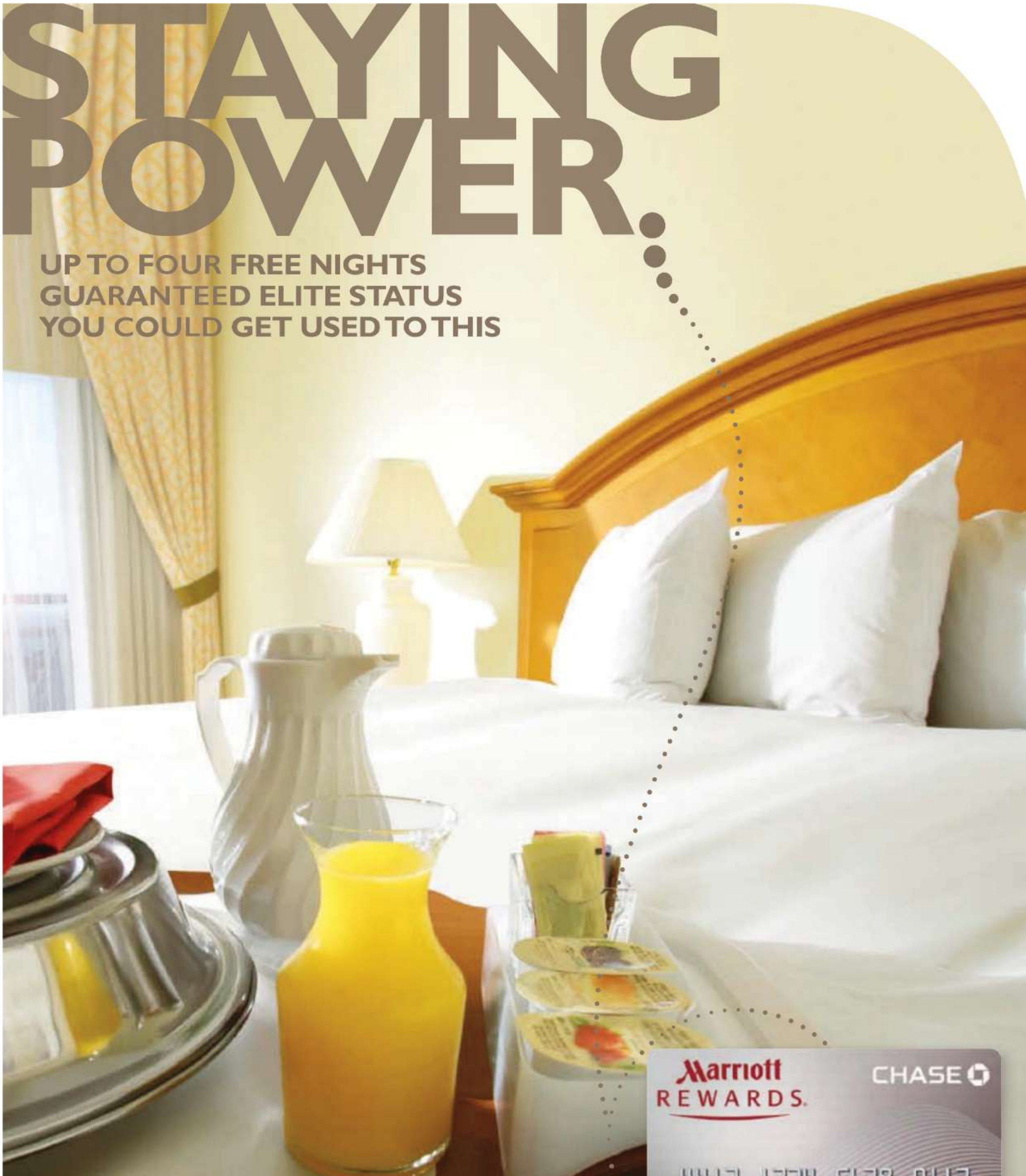
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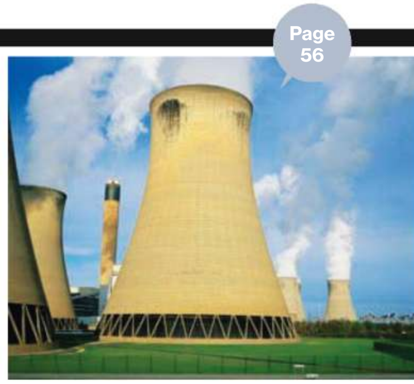
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Corrections & Clarifications

The Tech 100 (Features, May 24) mistakenly listed CA Technologies as a Brazilian company. It is American. A graphic in the Cover Story "Why Won't You Let This Man Invest Your Money?" (Features, May 31) erroneously measured investments by institutional investors and individual investors in millions rather than trillions. "Who Wants to Be a Spillionaire?" (Features, May 31) said Exxon fought a $5 billion damage award handed down in an Alaska state court for 19 years. It fought the award for 14 years.

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Opening Remarks



Obama examines some of the effects of a spreading crisis

LARRY DOWNING/REUTERS

Surviving the Spill

The oil disaster engulfs a British corporate titan and an American Presidency
By Paul M. Barrett

With failure heaped upon failure in the Gulf of Mexico, the environmental disaster now threatens the viability of not only a vast corporation but also a U.S. Presidency. The buck stops with both—one financially, the other politically. Can either recover?

The markets sent ominous signals about BP's future once it became clear over the Memorial Day Weekend that the top-kill plugging maneuver had not worked. In the Gulf, hurricane season has arrived, bringing with it the prospect of fierce storms chasing rescue ships to shore and spreading the sickening oil slick farther along the southern coast. A long, grim summer seems all but certain.

Its shares sharply depleted, BP, the largest oil and gas producer in the U.S., suddenly seems vulnerable to a breakup or takeover. In Washington, the Obama team appears to be flailing. (See Charlie Rose, page 29.) Trying to assert some form of authority, the President vowed to bring wrongdoers to justice. The promise seemed mostly like a distraction from frustrating reality: In the short term, President Obama can do little, if anything, to stanch the gushing well.

As much as any other challenge—Wall Street, health care, Afghanistan—the oil spill may define Obama as a leader. He either will find a way to rise to this occasion and make some broader use of the crisis in the Gulf, or it will permanently taint him.

This is a moment to think big and creatively. As distant as risky drilling rigs off Louisiana may seem from the New York financial laboratories where wizard bankers synthesized subprime credit derivatives, Obama could explain the important connections: How, after decades of antiregulatory fundamentalism in Washington, the feckless Minerals Management Service became the Securities & Exchange Commission of the oil business.

It is no coincidence that staff members at both agencies watched pornography on government computers when they should have been monitoring their respective beats. Although corruption and incompetence seem to have run deeper at the soon-to-be-dismantled MMS, the zeitgeist of the two places was similar, according to investigations and congressional hearings: Industry was to be trusted, even when government overseers had no more idea what transpired on the trading floor at Lehman Brothers or Bear Stearns than they did on the ocean floor beneath the Gulf of Mexico.

At both the Minerals Management Service and the SEC, employees watched porn on their computers rather than monitoring their industries

The question is: What will Obama do about it?

One route to political rehabilitation would be to redefine how government interacts with business. The goal he should articulate is protecting capitalism—and the society it's intended to serve—from the tendency of the profit-minded to go to extremes.

Profit-minded investors, meanwhile, have soured on BP. "We are very negative on the prospects for BP, and this situation has a real possibility of breaking the company," London-based investment bank Arbuthnot Securities said in a June 1 research note. That day the British energy giant's shares dropped as much as 17 percent in London, their biggest one-day decline in 18 years. The company's stock flattened on June 2, closing down 34 percent since the Deepwater Horizon exploded Apr. 20. That erased more than $58 billion (40 billion pounds) from BP's value.

Ivor Pether, who helps manage $9.2 billion at Royal London Asset Management, including BP stock, told Bloomberg News: "We're getting into share price territory where analysts speculate about takeover possibilities, because the loss of market value is much greater than the estimated 'worst case' costs." Buyers haven't surfaced yet, he added, "because the near-term uncertainty is so high." BP spokeswoman Sheila Williams declined to comment.

The company's woes grew worse when the Obama Administration announced June 1 that it will investigate potential criminal and civil violations related to the spill. "We will prosecute to the fullest extent of the law," U.S. Attorney General Eric Holder said. While Holder didn't get into particulars, troubling facts have already surfaced. The House Energy & Commerce Committee released internal BP e-mail showing that company employees had worried six weeks before the rig explosion that workers were struggling to control the well below. A criminal indictment of BP and other companies involved in the accident—perhaps for infractions of the Clean Water Act or other environmental laws—"is very likely," David M. Uhlmann, a former chief of the Justice Dept.'s environmental crimes section, told Bloomberg. Uhlmann, who now teaches at the University of Michigan Law School, pointed out that after the Exxon Valdez oil spill in Alaska in 1989, ExxonMobil pleaded guilty to charges of that variety.

Another potential line of prosecutorial inquiry, and one that could have more severe effects on BP, would focus on whether executives lied in formal statements to the government. Depending on how high up the chain of command the probe went, a cover-up investigation could seal the fate of Chief Executive Tony Hayward and underscore questions about BP remaining independent. The company has said it will cooperate with investigators.

While the FBI explores the nuances of pollution law, the White House promises daily to stem damage to the Gulf coastline and economy. "I'm confident people are going to look back and say this Administration was on top of what was an unprecedented crisis," Obama has told reporters. That seems increasingly doubtful. However the destructive gusher is stopped, Obama will have been the man in charge when we all realized that the White House isn't "on top of" much of anything when it comes to deep-sea oil.

The federal government that Obama inherited in 2009 had been more or less uninterested in keeping up with business over the course of three decades. "Industry has developed technology the government doesn't understand," says Richard B. Stewart, a professor of environmental law at New York University Law School.

As happened in the wake of the collapse of some of Wall Street's most storied investment banks, we are already beginning to learn that BP's internal communications show a reluctance to address what should have been dire warning signs. BP e-mail obtained by the House Energy Committee reveal that anxiety about the safety and soundness of the BP well was intensifying more than a month before the Apr. 20 blowout. This evidence, while fragmentary and inconclusive, may cast doubt on BP's contention after the explosion that the company was caught entirely by surprise.

A Mar. 10 e-mail from BP executive Scherie Douglas to Frank Patton, an MMS drilling engineer, said the company planned to sever the pipe connecting the well to the rig and then plug the hole. "We are in the midst of a well control situation on MC 252 #001 and we have stuck pipe," Douglas wrote, referring to the subsea area Mississippi Canyon 252. "We are bringing out equipment to begin operations to sever the drillpipe, plugback the well and bypass." BP received verbal approval from an unnamed MMS official at 11 p.m. on Mar. 11 to insert a cement plug at a shallower depth than normally would have been required after the hole caved in on the drilling equipment, the e-mail showed. Asked about these exchanges, a company spokesman said: "We have always said it was a complex accident. We await a full report."

As investigators reconstruct events leading up to Apr. 20, Sarah S. Elkind, an historian of politics and the environment at San Diego State University, warns against focusing on minutiae to the exclusion of the big picture. Within the MMS, she says, "The employees followed cues from political appointees during the Bush Administration and earlier Administrations, going back to 1980, and including Democrats as well as Republicans. The message was that

government doesn't work, and industry always knows what it's doing. What did we expect the employees to do?"

Industry, of course, doesn't always know what it's doing, NYU's Stewart notes. He headed the Justice Dept.'s environmental division in March 1989, when the Exxon Valdez dumped 250,000 barrels of crude into Alaska's Prince William Sound. For 21 years, until BP, that was the record U.S. oil spill. After the Valdez ran aground, it became clear that the industry lacked the plans or equipment to contain a spill of that magnitude, Stewart says. "Government had delegated most cleanup responsibility to the oil companies, and their response capability was in mothballs."

Congress responded belatedly with legislation in 1990 that required safer supertankers and a mechanism for the U.S. Coast Guard and other agencies to coordinate a cleanup—on the water's surface. That didn't help prepare for a blowout a mile below. Once again, government had deferred to the oil industry, and the giant company in question wasn't ready for a monumental snafu.

Obama has spoken expansively about restoring respect for government service. His occasionally populist rhetoric aside, he has been solicitous of corporate interests, too. Recall the astonishing bailout of General Motors. Just three weeks before the Deepwater Horizon exploded, the President had proposed expanding offshore oil exploration, in part as a bid for Republican votes for stalled energy and climate legislation. At the time, Obama praised advances in drilling technology.

"Where I was wrong," he said on May 27, "was in my belief that the oil companies had their act together when it came to worst-case scenarios." By his own admission, this product of Harvard Law School and liberal South Side Chicago politics was mesmerized, along with everyone else, by the myth of industry omnipotence.

The President also acknowledged that his Interior Secretary, Ken Salazar, who oversees the MMS, hadn't moved quickly enough to root out favoritism and laxity. In 2009, BP was granted a "categorical exclusion" that allowed the Deepwater Horizon to operate without analysis required by the National Environmental Policy Act. Obama said changes had been planned at Interior. "If they were happening fast enough, [BP's safety glitches] might have been caught."

In congressional testimony, Salazar has blamed the environmental lapse on a statutory 30-day deadline on the permitting process. The Administration says it will seek to extend that time limit to 90 days. Salazar exacerbated his department's bumbling image by repeatedly boasting about having a "boot on the neck" of BP. He even suggested that the company would be pushed "out of the way" if it didn't move faster. The tough-guy talk wasn't convincing. The government lacks the necessary engineers, undersea robots, and scientific expertise. This remains BP's show.

The director of the MMS is gone, and the agency has been divided in three, so that its collection of oil royalties won't undermine its policing function. Obama has imposed a six-month moratorium on new permits for deep-water wells. The sale of exploration leases in the Gulf of Mexico and off Virginia has been suspended. A big Arctic energy project will be delayed. The government will require tougher certification of the sort of equipment—the notorious "blowout preventer"—that failed on the Deepwater Horizon.

That's not stopping some Republicans from equating Obama's response to the crisis to President George W. Bush's lack of urgency in reacting to Hurricane Katrina in 2005. The National Republican Senatorial Committee is running a Web video juxtaposing candidate Obama's words about Katrina—"Never again"—with those of liberal commentators castigating him for acting "lackadaisical" about the Gulf crisis and seeming as ineffective as "a Vatican observer."

More measured critics recognize that neither party has covered itself with glory. "The truth of the matter is nobody knows how to fix this damned thing," Senator Lindsey Graham, a South Carolina Republican, told reporters, "and if they know how, they need to step up."

Until someone figures out how to fix BP's leak, the idea the President should stress is how to reframe the debate about oil, investment banking, and other technologically sophisticated industries. Obama should argue that we need better government oversight of business, not to harm it, but to nurture it. He could invoke the memory of the New Deal regulatory revolution, which shielded industry and finance from calls for socialism after the Great Depression.

He won't win over Tea Partiers who see the New Deal (and the income tax and civil rights laws) as constitutional infringements. But a majority in America may well be receptive to an appeal that Democratic pollster Douglas E. Schoen described this way in a roundtable on the politics of the spill on washingtonpost.com: "We are all in this together—not as corporations or populists, not as Democrats or Republicans, but as Americans working to solve the problem collectively." In a speech in Pittsburgh on the afternoon of June 2, Obama started in this direction, then swerved toward partisanship. The Republican agenda, he said, "basically offers two answers to every problem we face: more tax breaks for the wealthy and fewer rules for corporations."

For the foreseeable future, we need an oil industry. It should be one that worries about tough inspections so it avoids another Deepwater Horizon. For the longer term, as Obama argued in Pittsburgh, we need a comprehensive climate and energy bill that will create incentives to find alternatives to oil retrieved at great expense from the ocean depths or purchased from pernicious foreign sources.

In the same spirit, pending financial reform legislation aims to insulate Wall Street from its worst instincts and make it less of a threat to the rest of us. Bills waiting to be reconciled by the House and Senate would give regulators more authority to monitor complex securities, simple mortgages, and all manner of transactions in between. Financial firms would come under pressure to reduce debt and hold more capital in reserve. If a financial outfit began to fail, regulators would have more tools to disassemble it before a traumatic collapse.

Obama ran for President emphasizing results. Businesspeople like to talk about results, too. After a generation of operating according to a simplistic notion that defined government oversight as essentially poisonous to corporate success, now would be an opportune time to rally the country around an ideal of tough, fair regulation for the good of business and the customers it serves. B

—With reporting by Stanley Reed, Brian Swint, Joe Carroll, Jim Efstathiou Jr., and Justin Blum



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Russia Fights for World Dominance—in Wheat

▶ It may supplant the U.S. as the world's top exporter in less than 10 years

▶ "We are completely opportunistic. We ship anywhere there is demand"

On May 28, Egypt, the world's biggest importer of wheat, bought 180,000 metric tons from Russia for $178.50 per ton, about $13 less than the U.S. price. The deal is one of many signs that Russia is challenging America's supremacy in the global wheat market. In the past 11 months Russia has won 58 percent of Egypt's regular purchases of wheat, compared with 40 percent the year before. The U.S. share of Egypt sales fell to 8 percent from 13 percent over the same period, says Egypt's General Authority for Supply Commodities.

For Russia, it's an extraordinary turnaround. As recently as the 1990s, it had to buy wheat from U.S. farmers to feed its people, so inefficient were its farms after decades of ruinous Soviet practices. Then Russian investors slowly started buying land and introducing modern farming in the country's fertile "black earth" region near Ukraine and the Black Sea. In 2002 the country emerged as a major exporter for the first time in decades by selling 15.6 million tons abroad. "Exports suddenly became profitable," says Arkady

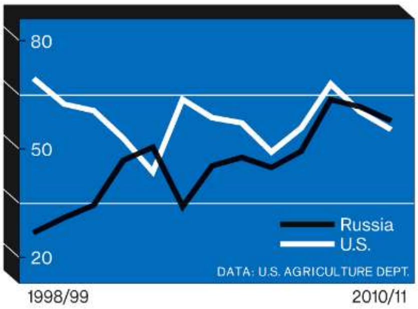


A Soviet-era statue depicts peasants on a communal wheat farm

FRANZ-MARC FREI/CORBIS

The Amber Waves of Russia

Russian wheat production vs. U.S. (millions of metric tons)



Global Economics

Toning shoes are gaining traction
page 22 ▶



Quoted

"We had a big expansion of spending, and there's a prospect of a sizable tax increase. If we continue along that direction, it will be unlikely we would avoid some sort of the disease that infected Europe."
—Michael Boskin, former chief economic adviser to President George H.W. Bush



Zlochevsky, president of Russia's Grain Union, a lobby group.

By 2008 global grain prices were reaching record levels, and Swedish, British, Chinese, and Korean investors were piling into Russian farmland. Today Russia exports 14 percent of the world's wheat, up from 0.5 percent in 2000. The U.S. share of wheat exports has slipped from 26 percent to 19 percent.

Moscow is now making dominance of the wheat market a goal, and it has a shot: The U.S. Agriculture Dept. predicts that Russia will become the top wheat exporter by 2019. President Dmitry Medvedev last year ordered the creation of a state company, **United Grain,** to modernize the storage and shipment of wheat in a $3.3 billion overhaul. United Grain will also pursue export deals in Southeast Asia and Latin America, says CEO Sergei Levin. Those regions are traditional strongholds for Australian and U.S. grain exporters.

U.S. farmers are worried. "The Black Sea region is becoming a bigger competitor for us," says Dean Stoskopf, 54, a wheat grower near Hoisington, Kan. Up to now, he says, U.S. farmers have commanded premium prices for higher quality—U.S. wheat generally has higher protein content than Russian grain and suffers less from insect infestations. That may change, Stoskopf fears, as the Russians improve their growing practices and storage facilities.

Some members of Congress want Washington to do more. "I would not rest on the attitude that we have a great product," says Senator Mike Johanns (R-Neb.), who was Secretary of Agriculture from 2005 to 2007. "Price is a factor. We should be working on free-trade agreements or very quickly we'll find ourselves behind." Free-trade agreements in certain parts of Latin America and Asia would open up new markets for U.S. wheat. Russia is part of a bigger problem, says Jason Britt, president of Central States Commodities in Kansas City, Mo. Wheat futures on the Chicago Board of Trade have fallen 32% in the past year as stockpiles have grown.

Kirill Podolsky, 39, is CEO of **Valars Group**, Russia's No. 3 wheat exporter. "We are completely opportunistic. We ship anywhere there is demand," he says at his headquarters in Taganrog by the Sea of Azov, which connects to the Black Sea. Valars will supply a third of the shipment in the Egypt deal. Podolsky founded Valars in 2006 and has spent $250 million on farmland and $108 million on equipment.

Vasily Pechersky, 64, who runs Valars' 41,230-hectare Sarmat farm, north of Taganrog, says his winter wheat yield was 4.4 tons per hectare, on a par with U.S. yields. He credits his U.S.-made New Holland tractors and harvesters as well as higher use of fertilizers and new technologies. "One New Holland harvester stands in for two Russian-made ones," he says. Russian-made tractors sit to one side, covered in rust.

The Russians still have challenges to overcome. Investors such as Podolsky bought land at top prices right before the global financial crisis and are struggling to pay off debts. Valars may sell shares on the market to repay $500 million of debt before investing anymore in farming: Wheat-growing brought "zero" profit last marketing year after a plunge in prices, says Podolsky. The Grain Union is asking Moscow for $320 million in subsidies to improve the profitability of exports. Such state aid could help Russia's growers compete even more ferociously with the U.S. on price.
—Maria Kolesnikova and Tony C. Dreibus with Ola Galal and Michael Arndt

The bottom line *As Russia strives to replace the U.S. as the world's No. 1 exporter of wheat, pricing pressure will remain intense, affecting profits for all players.*

Drawing Board



PHIL MCCARTEN/REUTERS; ILLUSTRATION BY PAVEL CONSTANTIN/CAGLE CARTOONS

Labor markets

In Search of the Ideal Jobless Rate

▶ **Inflation may break out if unemployment targets are too low**

▶ **In the 1970s, the Fed went for full employment. Disaster ensued**

America may have a new Nairu. Developed by the late economist Milton Friedman, Nairu is the unemployment equivalent of Goldilocks' perfect bowl of porridge—a jobless rate that's not so high it triggers deflation or so low it sets off galloping inflation.

Nairu stands for nonaccelerating inflation rate of unemployment. Every economy has one. Sometimes it is referred to as the natural rate of unemployment. The factors that influence a country's natural rate of unemployment are many: The bargaining power of unions, the productivity of the workforce, the presence of minimum wage laws, and the willingness of workers to relocate are just a few of them. Europe's Nairu has traditionally been around 8 percent, says Johns Hopkins University economist Laurence Ball. Economists estimate that the U.S. has had a natural rate of unemployment of 5 percent since the mid-1990s. That relatively low level has given the Federal Reserve room to maneuver in setting interest rates.

Now many economists, including Dean Maki at Barclays Capital, 2006 Nobel Prize winner Edmund Phelps, and Bank of America Merrill Lynch's Ethan Harris, think the financial crisis has pushed the U.S.'s natural rate of un-



30%

Overweight Chinese as a share of adult population

DIEGO AZUBEL/EPA/CORBIS. DATA: BARRY POPKIN, INTER-DISCIPLINARY CENTER ON OBESITY, UNC CHAPEL HILL

employment to between 6.3 and 7.5 percent. It may seem odd to worry about such things, with the jobless rate stuck above 9 percent and the economy flirting with deflation. Yet the stakes are high.

As Barclays' Maki explains it, the U.S. labor market is tighter than it appears. Many jobless were trained for work that has been wiped out. Some of these unemployed aren't qualified for the highly skilled jobs that often go begging. When employers do find the right candidates, they have to pay them competitively. Other factors restrict the labor pool further. People whose homes are worth less than their mortgages are reluctant to move for work. Extended unemployment benefits deter some people from accepting jobs.

If Maki and other economists are right, then the Fed could damage the economy by keeping rates low for too long. In this scenario, loose monetary policy lasts until the jobless rate slips beneath the new natural rate of 7 percent, and inflation breaks out. "You could be sitting at a zero-percent fed funds rate at full employment and not realize it," says Maki.

That's what happened in the 1970s as Maki tells it. The Fed thought the natural rate of unemployment was 4 percent and kept borrowing costs low in hopes of reaching that target. That led to double-digit price increases. Policymakers ended up raising their benchmark rate to 20 percent in the early 1980s, at tremendous cost to the economy. The natural rate, it turns out, was more like 7 percent, according to Maki.

A higher natural jobless rate would be a drag on the budget deficit, because the government would collect less tax revenue from the employed while spending more on jobless benefits. The Fed is not sounding the alarm about Nairu. Yet in the minutes of the latest Federal Open Market Committee meeting on Apr. 27-28, two participants estimated that longer-run unemployment would settle in at 6 to 6.3 percent, barring any more big shocks to the economy. Longer-run unemployment is considered a proxy for Nairu. A year earlier, none of the participants projected a longer-run rate higher than 5.3 percent.
—Caroline Salas, with Rich Miller

The bottom line *The natural rate of unemployment may have drifted up to 7 percent. If so, that makes the Fed's timing on tightening much trickier.*

Health

China Discovers The XXL Way of Life

▶ **Companies are growing alarmed at their workers' expanding waistlines**

▶ **Fruit bar sales are hot. So is bariatric surgery**

As an only child growing up in Shanghai, Simon Wang was plied with dumplings, ice cream, and Kentucky Fried Chicken by his parents and grandparents. After tipping the scales at 220 pounds, the 26-year-old decided to join Weight Watchers last month.

"I will get a heart attack more easily than a normal person," says Wang, who is 5 feet, 9 inches tall and wants to shed 55 pounds. "When I get older I will have lots of problems, maybe high blood pressure and a lot of other illnesses."

After struggling for millennia to feed its population, China, the world's fastest-growing major economy, now faces the opposite problem. Some 30 percent of adults are overweight or obese, com-

pared with 25 percent in 2004, figures Barry Popkin, director of the Inter-Disciplinary Obesity Center at the University of North Carolina at Chapel Hill. In Beijing, 40 percent of Chinese boys struggle with their weight. Greater affluence, less physical activity, and a diet with more meat and processed food have expanded girths. The problems are most pronounced in cities like Shanghai and Beijing, where more people drive and have easier access to fast food. (Just to compare, the American Medical Assn. estimates that 68 percent of U.S. adults are overweight.)

The rising rates complicate China's plan to overhaul a health-care system that leaves more than 300 million people without insurance. The government is spending $125 billion to provide coverage for all 1.3 billion Chinese by 2020. The plan includes only basic benefits, not services such as outpatient care for chronic diseases linked to obesity, says Wang Shiyong, senior health specialist at the World Bank in Beijing.

More than 92 million Chinese adults suffer from Type 2 diabetes, caused mainly by a high-calorie diet and sedentary lifestyle, according to a study in the Mar. 25 *New England Journal of Medicine*. Based on this data, the International Diabetes Federation in Brussels estimates close to half a billion Chinese will have the disease by 2030. The government "is very concerned," says Chen Chunming, professor of nutrition at the International Life Sciences Institute in China, a state-affiliated public-health organization.

Calorie counters like Wang are creating demand for the low-fat foods and weight-loss programs that figure so prominently in the U.S. Sales of soy and fruit bars are growing "really fast, especially to office ladies who are so afraid of gaining weight," said Michael Zhang, chairman of **Otsuka (China) Investment**. Tokyo-based Otsuka makes the popular Soyjoy bar, which has been available in China since 2008, and Zhang says Soyjoy sales there will overtake those in the U.S. this year. **Weight Watchers China**, a joint venture between **Weight Watchers International** of New York and Paris-based **Danone**, the world's largest yogurt maker, opened its first center in Shanghai in August 2008. It has since opened three more there, another in Nanjing, and plans to expand to other cities, according to Shan Jin, director of program development.

The desire to lose weight and achieve "a more healthy lifestyle" are also luring customers for Zhongti Beili Health Club, a joint venture of **Bally Total Fitness** of the U.S. and Beijing-based **China Sports Industry Group**, according to the venture's deputy general manager Derek Xue. The company plans to double its chain of gyms to 28 by yearend, he says.

China has about 3,000 health clubs, with about 3 million active members, estimates Marco Treggiari, China managing director of Italy's **Technogym**. The equipment maker supplies about 400 independent gyms and facilities in 210 five-star hotels. Sales will grow as much as 30 percent this year, to $18 million, he says.

Corporate clients are becoming an important source of that growth. **Dow Chemical** has equipped a 2,600-square-meter sports facility in its Shanghai headquarters with Technogym treadmills and step and weight machines, says Fiona Bao, Dow's medical director for North Asia Pacific. "Obesity is no longer just a personal-health issue. It's related to productivity," she says.

Some Chinese are opting for a quicker fix. Zheng Chengzhu, chief of minimally invasive and bariatric surgery at Changhai Hospital in Shanghai, says he performs about 100 obesity-related operations a year, compared with 20 to 30 a few years ago. **Allergan**, maker of a device used in gastric-banding surgery, has applied to the government to sell its Lap-Band in China, says Judy Low, a company spokeswoman in Singapore.

One incentive for a smaller waistline, beyond better health, is the potential to make more money. Wu Yu'e, 23, an engineer who joined Weight Watchers, says employers in China place a premium on physical beauty especially for women. If she slims down, she says she will get a higher-paying job. "It will also help me find a boyfriend," she adds.
—*Frederik Balfour*

The bottom line *China is struggling with the diseases of affluence, as diets grow richer and lifestyles less active. Companies like Weight Watchers benefit.*

15.2

MILLION DOLLARS

The money won and squandered by Michael Carroll, a British sanitation worker who spent his 2002 lottery winnings on drugs, prostitutes, parties, and gifts to friends and family

Fiscal Politics

Making the Well-Off Pony Up



Governments around the world want to levy new taxes on their affluent citizens. President Barack Obama's 2011 budget calls for a return to a top U.S. tax rate of 39.6 percent for joint filers earning more than $250,000 a year. The current rate is 35 percent. Obama's budget also restores capital gains taxes to the 2001 level of 20 percent, from 15 percent now, for those in the top bracket. Here are other proposals. —*Caroline Winter*

Britain

The Conservative-Liberal Democrat coalition just announced plans to tax capital gains on shares and sales of second homes at rates "closer to those applied to income." That could mean a sharp jump from the current 18 percent capital-gains rate.

Spain

On May 26, Spain's Prime Minister José Luis Rodríguez Zapatero said that the wealthiest should be taxed more than the current 43 percent to help close the budget deficit, the euro zone's third-largest.



Cargo trucks from the South on their way to Kaesong

WOO YOUNG-SHICK/YONHAP/AP PHOTO

Tension in Korea

Commerce Is Caught in A Crossfire at the DMZ

▶ South Koreans at an industrial park in the North fret about a shutdown

▶ "Frankly speaking, I'm nervous. I stand to lose everything"

It's a commute that makes rush hour in London or Los Angeles seem positively relaxing. For the 900 South Koreans who work at Kaesong, a capitalist enclave 10 miles inside North Korea, the daily routine involves checking in with Southern soldiers, locking cell phones in a box at customs (they're banned in the North), and passing through the demilitarized zone, a mile-wide stretch of razor wire that marks the world's most heavily fortified border.

The trip to the Kaesong industrial park has gotten even more tense lately. On May 20, South Korea said the North was responsible for the March sinking of one of the South's warships and threatened to cut off trade. The North retaliated with threats of "all-out war" and said it may close the border. "Frankly speaking, I'm nervous," says the South Korean owner of a Kaesong clothing factory. "I stand to lose everything." Like many other Kaesong workers, he asked not to be named.

While the rhetoric escalates, the Kaesong commuters continue to make their way across the border every day. That's because both sides have much to lose from a shutdown. The South Korean government and the 121 Southern companies that operate in Kaesong have invested more than $1 billion there since the park opened in 2003, part of an effort to improve ties between the two countries and give the North a dose of capitalist discipline. For the North, Kaesong provides 40,000 jobs, and most of the workers' pay–some $50 million a year–ends up in the government's coffers. "North Korea has more to lose economically," says Kim Yong Hyun, professor of North Korean studies at Dongguk University in Seoul. But he predicts the North might still close Kaesong if the government feels threatened. "The regime's stability is much more important than economic benefits," Kim says.

That uncertainty is rough on companies at Kaesong. Their biggest fear is that they might be cut off at the whim of the North's "Dear Leader," Kim Jong Il. "The Seoul government has to take some responsibility," says a textile executive. He says production was normal until recently, but orders have since fallen sharply and one of his Southern managers refuses to work in the North.

Fearing that exports to the South may be blocked, managers have limited the supplies they keep on hand. That has sparked complaints from North Korean middle managers who say they can't do their jobs, says Park Heung Jae, chief of a small-appliance factory in Kaesong.

The clothing factory owner, who has invested about $4.8 million in Kaesong, says he has received "zero" orders since the crisis began as buyers worry that their orders may not be met. After Seoul in May suggested limiting the number of South Koreans at Kaesong, he has kept only two Southern managers there instead of the typical seven, though he fears quality will suffer. While relations between workers and managers remain friendly, they're also tense, says a Southern manager at the plant. "No one talks about the warship incident," he says, "even though each of us knows the others know about it." —*Bomi Lim, Sangim Han, and Kevin Cho*

The bottom line *The Kaesong park was built to help open the North's economy. Now, South Korean managers there fear for their investments.*

Sweden

Sweden's three-party opposition alliance, which leads in most polls running up to parliamentary elections on Sept. 19, pledged on May 3 to raise income taxes for top earners.

Portugal

In March the government raised the rate on personal income tax to 45 percent for income above $182,000 annually. The previous maximum tax rate was 42 percent.

Greece

On Mar. 3, Greek Finance Minister George Papconstantinou added a tax bracket of 45 percent for Greeks declaring incomes of more than $121,000. Before then, the highest tax rate was 40 percent.

Mexico

In January 2010, Mexico's government raised the income tax for high-earning individuals to as high as 30 percent. The tax is scheduled to drop back to 28 percent in 2014.

France

French Labor Minister Eric Woerth is negotiating with business leaders over new taxes for the wealthy.

U.S.

Oregon voters approved an income tax hike to 10.8 percent, from 9 percent, on households earning more than $250,000. In Washington State, a proposed ballot would create an income tax, the state's first, of 5 percent for individuals earning more than $200,000.

Global Economics

Natural Resources

Australia Grabs for Mineral Riches

▶ Mining companies attack Australia's proposed windfall profits tax

▶ "It's going to be a tough fight," says Prime Minister Rudd

Somewhere in the outback, a rugged-looking man walks toward his SUV, looks directly at the camera, and warns about the dangers of a proposal to raise taxes on Australia's mining companies. "Billions of dollars of investments are already on hold," he tells viewers on TV and the Internet. Describing a future of job losses and lower returns for pension funds, the man asks ominously, "Who will be hurt by this super tax? Everyone."

The ad is part of an ad blitz launched by mining giants including **BHP Billiton** to kill Prime Minister Kevin Rudd's plan for a 40 percent windfall profits tax on the industry. Rudd's Labor government is initiating a $30 million ad campaign of its own to counter the industry's efforts.

Right now polls indicate 41 percent of Australians oppose the tax and 36 percent support it. The opposition Liberal Party condemns the idea. Australia's treasurer, Wayne Swan, said in an e-mail that the tax would raise $10 billion in its first two years. That "will allow the government to cut business taxes, especially for small business, boost retirement savings, and invest in infrastructure."

Investors are concerned that the tax, which still needs to pass in Parliament, would especially hurt companies that operate mostly at home. After news of the proposal, shares in **Fortescue Metals**, an iron ore company that does all its mining in Australia, dropped 25 percent. The price of the Sydney-traded stock has since climbed back 13 percent amid optimism that the well-organized expressions of outrage will force the government to back down. Like BHP and **Rio Tinto**, Fortescue may reconsider investing in Australia. As Rudd told reporters on May 30, "it's going to be a tough fight." Ⓑ —*Bruce Einhorn, Marion Rae, and Elisabeth Behrmann*

The bottom line *The Labor government in Australia wants a windfall profits tax on mining companies. The industry is launching a well-financed counterattack.*

Education

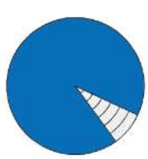
More Graduates, More Job Seekers

It's graduation time at colleges around the world, and the job market is a little more welcoming to 21-year-olds than it was in the depths of the recession. Still, graduates are struggling to find their place in the workforce, with high rates of unemployment and underemployment in the industrialized world. Here's a sampling. —*Ira Boudway*



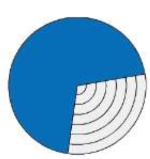
U.S.

A survey by the National Association of Colleges & Employers found that **24.4 percent** of 2010 college graduates who applied for a job have one waiting after graduation, up from 19.7 percent last year.



Japan

According to a joint survey by the labor and education ministries, the employment rate for students who graduated in March is **91.8 percent**, a 3.9 percentage point drop from last year and the lowest rate since 2000, when 91.1 percent of graduates were able to find work.



China

The Human Resources & Social Security Ministry hopes to place **70 percent** of the graduating class by July and aims to push that figure to 80 percent within the year. Last year 68 percent of the graduating class was placed by July 2009 and 87 percent within the year.



Great Britain

A survey of 16,000 students by High Fliers Research found that of the 55 percent of final year students who have already applied for positions, **15 percent** have received offers so far, slightly above last year's rate.

Tom Keene's EconoChat

Tom talks with Sanford C. Bernstein's Brad Hintz about Goldman Sachs, the Street, and the banks.

What's the new-new with Goldman and the SEC suit?
It started out as a Goldman crisis and then kind of became an industrywide issue, not unlike what we've seen with Enron or WorldCom.

Are they going to settle out of court?
Of course. You don't want to be at war with your regulators. And when we met with Goldman, Goldman's management said it wanted a normal relationship with regulators. I think the issue is, when will the settlement come?

What's your price target on Goldman?
Over 200. [Goldman trades at 141.]

Are the banks still staggering quarter-to-quarter?
No, they're through the worst at this point. It certainly looks like we've got the economy recovering–and betting against the U.S. economy tends to be a loser's game. For the banks, I think the issue is what kind of exposure you have to Europe.

What is the best-run bank in America right now of the majors?
I think I'll go with Jamie Dimon of JPMorgan Chase. I think he's ridden a pretty good horse.

Is the old Wall Street going to come back?
It's going to take us another three years probably before we get back to where we were.



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM129, Sirius 130.*

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June 20–22, 2010 USA Pavilion, Shanghai

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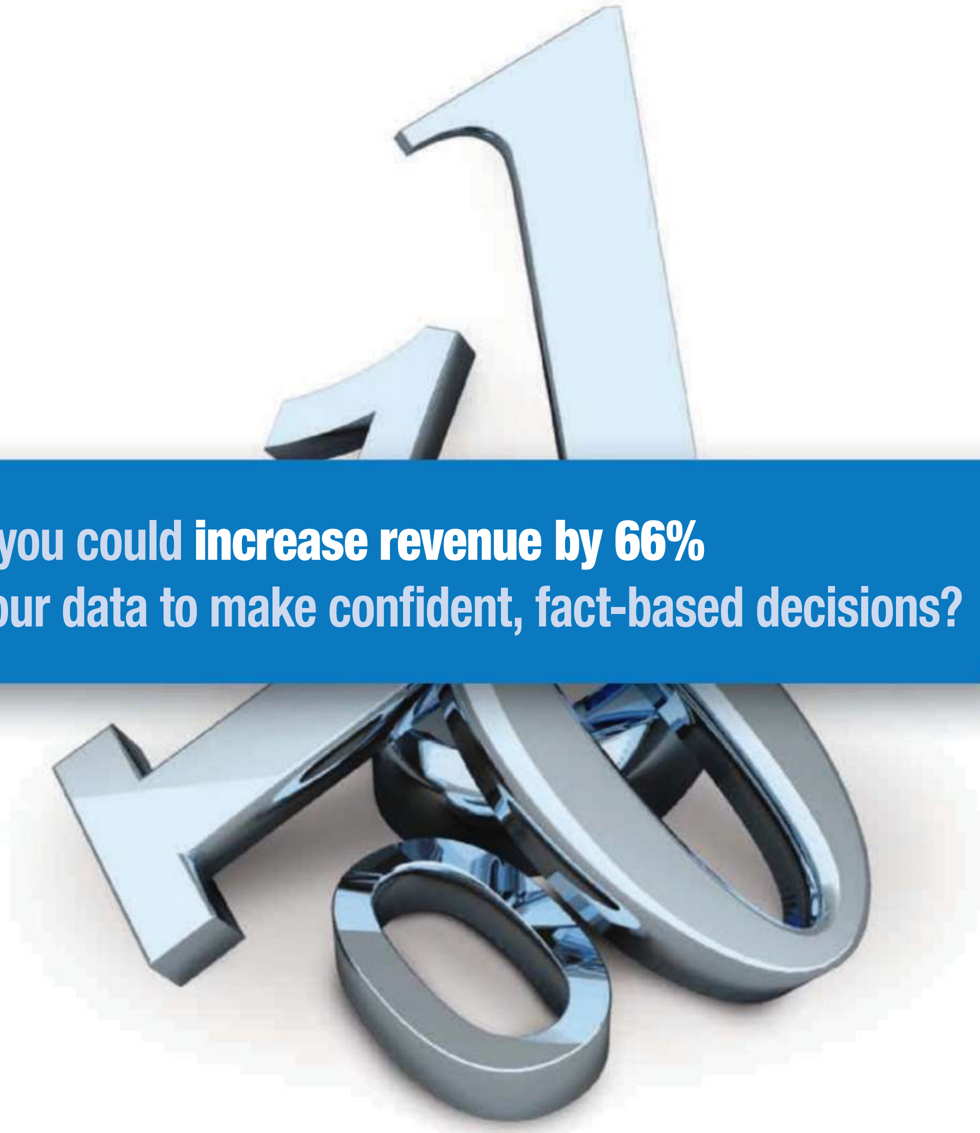
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Companies&Industries



No lifeline: Merkel tours an Opel factory in Ruesselsheim, Germany

GM's Fast Turnaround Slams into the Euro Crisis

▶ **With its budget tight after the Greek bailout, Germany rethinks helping to rescue Opel**

▶ **"It's an open secret that I have viewed the whole matter with skepticism from the beginning"**

Since exiting bankruptcy last July, **General Motors** has revived its once-fusty product line, repaid $8.4 billion in bailout loans to U.S. taxpayers, and logged its first quarterly profit since 2007. That swift turnaround has set the stage for an initial public offering for America's largest car company by early 2011.

The fast-mending automaker encountered disappointment on June 1, however, when a German government panel refused GM's request for 1.1 billion euros ($1.3 billion) in German aid for its money-losing Opel unit. The group of outside advisers assumed a "very critical attitude" toward GM's application, Economy Minister Rainer Bruederle said on June 1. "The advisory panel's recommendation will carry major weight for the further decision-making process."

With Chancellor Angela Merkel's cabinet scheduled to hold a two-day meeting starting June 6 in Berlin to single out further budget cuts necessary after joining in the bailout of Greece, politicians see little room for helping Opel. GM is pursuing aid from Germany and other European nations even after posting first-quarter net income of $865 million.

"We cannot possibly tell the people 'you have to put up with higher costs' while we're propping up a company that is perfectly able to cope by itself," said Michael Fuchs, deputy member of parliament's economics committee. "I don't expect the government to grant aid."

A person familiar with GM's plans says the company can probably cope without Merkel's aid—but would probably then cut more German jobs.

The steering committee for aid assistance, led by Deputy Economy Minister Bernhard Heitzer, was set to meet June 4, with a final decision on GM's petition expected the following week, Bruederle said. "It's an open secret that I have viewed the whole matter with skep-

HANNELORE FOERSTER/BLOOMBERG

ticism from the beginning," he said.

GM is seeking European aid of 1.92 billion euros to help fund Opel's 3.58 billion-euro reorganization. It's asking Germany to provide loan guarantees of 1.1 billion euros, according to a report commissioned by the government and obtained by Bloomberg News. Opel says it already has pledges for 437 million euros in guarantees from Austria and Spain, plus 333 million euros from Britain; Germany is the lone holdout.

"At the end of the day, it's a decision by the [German] government steering committee," Stefan Weinmann, a spokesman for Opel said on June 1, prior to Bruederle's statements. "We're going through the process."

GM plans to eliminate 8,300 of Opel's 48,000 positions. European governments pledging aid are seeking to avoid factory closures and minimize job cuts. GM has already said it will shut a plant in Belgium if it doesn't find a buyer for the site by late September.

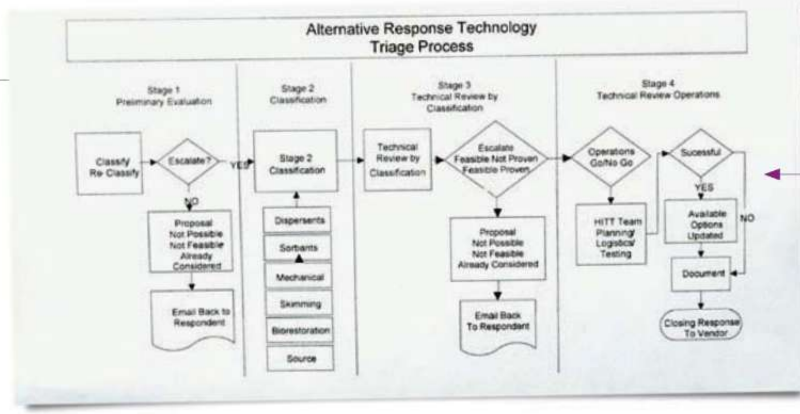
GM reached an agreement with Opel unions on May 21 to cut labor costs by 265 million euros a year. The savings are tied to GM commitments to invest in such new products as a convertible and a minicar. Klaus Franz, Opel's top labor leader, said the agreement would not be affected by a German decision on aid because lost salary and bonuses will be returned to employees if GM fails to fulfill investment commitments. Still, Germany's biggest union, IG Metall, will stage a protest rally in Frankfurt on June 7 to pressure Merkel to provide guarantees. —*Andreas Cremer and Chris Reiter, with David Welch*

The bottom line *After a painful bankruptcy, General Motors is on the mend. That's making it harder for the carmaker to get German government aid for Opel.*

Quoted

"They made big mistakes, but who didn't during the housing bubble?"
—Warren Buffett, chairman of Berkshire Hathaway, talking to Bloomberg Television on June 2 about embattled debt rating agency Moody's Investors Service, in which Berkshire holds a 13 percent stake





BP's decision-making road map

Energy

As the Spill Continues, Cleanup Ideas Wait

▶ Thousands of would-be saviors have responded to the call for fixes

▶ "Everybody comes out ... with their own brand of magic dust"

BP has received almost 35,000 ideas in just over a month on how best to clean up the millions of gallons of oil from the biggest spill in U.S. history. So far, only four have made it into testing.

That has left people such as Ken Griffin and James Reindl frustrated. Both run companies that specialize in oil cleanup products they say are more efficient and less toxic than what's in use in the Gulf. They contacted BP through its online suggestion box to offer help. Griffin on May 29 received a form letter saying his product is being considered, a month after he submitted it. Reindl has heard nothing, he said. "We think we have something to contribute," Griffin said. "It's just not at all clear what the chain of command is down there."

The proposals face a grueling–some say sclerotic–vetting, called the Alternative Response Technology Triage Process. The suggestions gathered through phone calls and the website, run jointly by BP and the U.S. government, are fielded by 70 workers. The most promising are then reviewed by 43 engineers from BP, the U.S. Coast Guard, and other U.S. agencies, according to Graham MacEwen, a BP spokesman.

If the ideas–which range from soaking up oil with human hair to enlisting oil-eating microbes–are seen as practical and don't overlap with proposals already being explored, they're sent to smaller teams of engineers to see if they can be applied, MacEwen said. About 800 proposals have made it to this stage, with just one-half of 1 percent of those in testing, he said. Most are duplicative or infeasible, MacEwen said.

Reindl is co-owner of Ecser Holding, maker of a devulcanized-rubber product called Spill-Cure that can absorb up to eight times its weight in petroleum products, he said. Reindl understands it's tough sorting through so many suggestions. "Still," he said, "it's frustrating for a group like us. It's like, 'Guys, we're right here.'" Griffin's company, Impact Services, makes Pristine Sea, a clay-based product that binds crude into soft clumps that can be skimmed from the water. The company says it has been tested in the Baltic Sea, and Louisiana State University is currently testing Pristine Sea on samples from the Gulf spill. "When things like the spill happen, everybody comes

Managing the Idea Flow

35,000
ideas submitted

800
ideas made the first cut as practical and not duplicative of current effort

200
maximum number of words allowed to describe the technology

70
workers fielding calls from people with ideas

43
engineers determine the technical feasibility of finalists

4
ideas that have reached testing so far

2
number of Academy Award winners in the running

DATA: BP, JOINT UNIFIED COMMAND CENTER, BLOOMBERG

Don't call him Governor Moonbeam page 31 ▶



out of the woodwork with their own brand of magic dust, but often it hasn't been tested," says Greg Broda, executive vice-president at Impact Services. "We have a viable, tested, nontoxic product, and we're having a problem getting anyone to listen to us."

One of the few ideas already in testing is centrifuge technology developed by actor Kevin Costner and his scientist brother Dan. The Costners didn't go through the technology triage process. They had help from Billy Nungesser, president of Plaquemines Parish, a district in Louisiana. Nungesser sent a letter on Costner's behalf to Doug Suttles, BP chief operating officer for exploration and production.

Director James Cameron, whose film *Titanic* gave him experience with the use of underwater remote vehicles, was invited to the Environmental Protection Agency with a group of scientists June 1 to discuss possible solutions. Even with help, Costner's firm has met with delays, and open-water testing won't start until this week.
—Pat Wechsler and John Lauerman

The bottom line *Ideas on how to clean up the Gulf spill have been flooding in. But few have made it into actual testing, frustrating entrepreneurs.*

OPPOSITE PAGE: DANIEL ACKER/BLOOMBERG; THIS PAGE FROM TOP: RUSSEL A. DANIELS/AP PHOTO; EVERETT COLLECTION

Entertainment

Creditors Seek Leads For MGM, the Sequel

▶ **The studio's debt holders weigh running the back lot themselves**

▶ **"I told them then that they had a melting ice cube"**

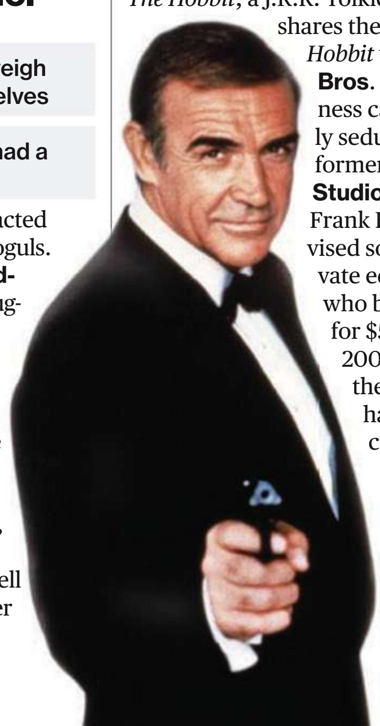
An unusual casting call has attracted some of Hollywood's biggest moguls. The role: rescuer of **Metro-Goldwyn-Mayer**, the film studio struggling under $3.7 billion in debt left over from a 2005 buyout.

Former **News Corp**. President Peter Chernin and Jonathan Dolgen, **Viacom**'s onetime Hollywood chief, recently auditioned for the job. The decision makers will be MGM's creditors, who must figure out whether it makes more financial sense to sell to **Time Warner**, the high bidder in a March auction, or to run the studio themselves. MGM, owner of franchises that include James Bond and Pink Panther, is suffering from a lack of hits and the industrywide slump in DVD sales.

The lenders, which include Highland Capital Management and Anchorage Advisors, already have learned one of Hollywood's first lessons: Never bet your own money on the movie business. Loans that traded at 65 percent of face value in January changed hands for as little as 43 percent in late May–valuing the company at $1.6 billion. That's close to Time Warner's $1.5 million high bid, according to people with knowledge of the auction. If the creditors decide to turn it down and go into show business themselves, they may have to put up some $500 million to jump-start production.

"They're trying to understand how they do it," says Clark Hallren, managing partner of the Los Angeles-based entertainment advisory Clear Scope Partners. "Do we need to keep domestic theatrical distribution? Do we continue to outsource home-video distribution? What kind of movies should we make?"

Delays in resolving MGM's fate have further clouded its outlook. Producers Barbara Broccoli and Michael Wilson, who co-own the lucrative 007 brand with MGM, suspended production on the 23rd Bond film in April, citing "uncertainty"about the studio's future. On May 30, director Guillermo del Toro bailed from MGM's upcoming *The Hobbit*, a J.R.R. Tolkien movie. MGM shares the rights to *The Hobbit* with **Warner Bros**. "The film business can be awfully seductive," said former **Universal Studios** Chairman Frank Biondi, who advised some of the private equity investors who bought MGM for $5 billion in 2005. "I told them then that they had a melting ice cube."



The Broccoli family has urged Warner Bros. to stay in the bidding, said three people with knowledge of the situation. Scott Rowe, a spokesman for Warner Bros., declined to comment, as did Susie Arons, an outside spokeswoman for MGM. Stephanie Wenborn, a spokeswoman for Broccoli and Wilson's London-based Eon Productions, also declined to comment.

With new management, the creditors hope to boost production, cut costs, and eventually seek a price of more than $2 billion for the studio, said two people who have discussed the plan with them. Finding ways to maximize MGM's value won't be easy, says Mark Patricof, managing partner of investment bank MESA. "There are not that many new faces out there with a lot of new ideas for MGM to consider," he says.

Patricof says the creditors should instead sell off MGM's assets, including its rights to the *Stargate* TV series. The Bond franchise could fetch $750 million alone, according to Douglas Lowell, who advises independent film companies on film financing. Its last five installments averaged $461 million in worldwide ticket sales. Whatever the outcome, the creditors aren't the only ones looking to get paid. Actor Tom Cruise, who signed on with MGM in 2006 and helped raise $500 million to produce films, owns a 30 percent stake of MGM's **United Artists** film unit, according to one former MGM executive. "Tom is protected and will be fine," says Cruise's attorney, Bert Fields.
—Ronald Grover and Michael White

The bottom line *MGM's valuable franchises make creditors believe they can profit by reviving the storied studio. It won't be easy.*

Advertising

In the Middle East, A Surge in Online Ads

▶ **Marketers turn to the Internet to reach the Arab world's 300 million**

▶ **"The numbers are there, and we have a vibrant advertising market"**

In 2006, with the Egyptian economy on course for its biggest growth in at least two decades, Con O'Donnell's business was in trouble. **Sarmady Communications**, his Cairo-based digital media company, was struggling to

attract advertisers to its websites. "Our business is creating content and selling advertising, and we ended up saying, 'do you want us to do a website for you?' We would do those things to have some cash flow."

Four years later, Sarmady has three offices, and its sports and entertainment websites are awash with advertisements from companies such as **Toyota Motor**, **BMW**, **adidas**, and **Telecom Egypt**. Revenue more than tripled, to $2 million in 2009, and may reach $4.3 million this year, O'Donnell said.

The turnaround reflects new marketing strategies across the Middle East region of 22 countries and more than 300 million people. Over the past two years companies have begun to increase spending online, taking advantage of the growing number of Internet users and inexpensive multimedia technologies to advertise their products.

Spending on online advertising in the Arab world may surge to about $400 million within four years from about $90 million in 2009, said Samih Toukan, chief executive of **Jabbar Internet Group**, which owns online businesses such as e-commerce website Souq.com. That's in contrast to the recent performance of online advertising worldwide, which fell 2.4 percent in 2009, to $26.4 billion, research group IDC said in March.

A growing number of Arab businesses are "looking at the return on their [ad] investment and the best way to track that is online," said Husni Khuffash, **Google**'s regional manager for the United Arab Emirates, Lower Gulf, and Levant.

Large Internet companies are taking note of the region's recent vigor. Last year, **Yahoo!**, owner of the second-most-popular U.S. search engine, paid $164 million for Arabic-language Internet venture **Maktoob.com**, which owns e-mail, search, auction, and entertainment websites. In 2008, **Vodafone Egypt** took a majority stake in Sarmady.

"There is a lot of room for advertising to grow, unlike other mature markets," says Ahmed Nassef, managing director for Yahoo! in the Middle East. "The numbers are there, and we have a vibrant advertising market" of as much as $9 billion in the Gulf Arab countries and elsewhere in the region, he says. Ad sales at Yahoo! Maktoob expanded more than 50 percent in 2009, says Nassef.

Microsoft's MSN gained first-mover advantage five years ago, with an Arabic version of its portal operated by **LinkdotNet**, an Egyptian company that owns nine sports, financial service, and entertainment ventures. The company now also operates MSN North Africa and another site dedicated to Pakistan.

Online ads are "doing super well; it surprises most people," says Karim Bichara, the 35-year-old CEO of LinkdotNet. The company expects revenue this year to surge 110 percent.

In February, LinkdotNet's advertising arm, Connect Ads, signed an agreement to sell ads in the region for social media site **Facebook.** Last month, Sarmady launched the Arabic-language version of the official website of the National Basketball Assn., which has a strong following in Arab nations, including Lebanon, Jordan, and the Arab Emirates.

Still, challenges abound for online operators in the Middle East. Broadband penetration has picked up only in the past few years and remains low—12 percent in 2009, according to a study by the Dubai Press Club, compared with 64 percent in North America.

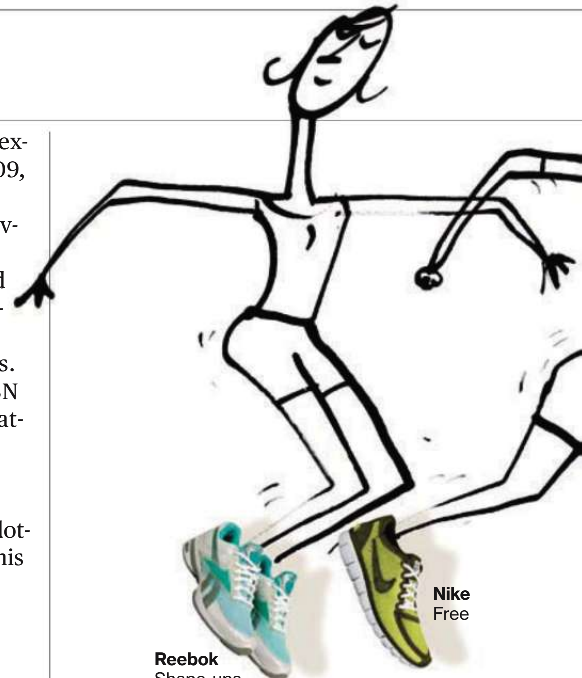
That's pushing many online ad and content companies to tap the mobile phone market, which has more than 230 million users in the region, according to Jawad Abbassi, general manager of Amman-based research company Arab Advisors Group.

Of Sarmady's projected revenue this year, 40 percent will come from ads on the cellular applications of websites. Its flagship, sports website FilGoal.com, has already attracted campaigns from such advertisers as Egyptian vehicle assembler and distributor **GB Auto**.

The lack of content is also a potential stumbling block. While 5 percent of Internet users worldwide are Arabs, only 1 percent of content is in Arabic, Nassef of Yahoo says. "If we grow content, that's going to increase user engagement online, and it will help grow the industry too."

—Alaa Shahine and Massoud A. Derhally

The bottom line *Internet advertising is growing fast in the Arab world. Low broadband penetration and lack of content in Arabic are challenges.*



Nike Free

Reebok Shape-ups

Apparel

As Nike Scoffs, Toning Shoes Gain Traction

▶ The unstable shoes cause muscles to work harder, makers say

▶ "The ... consumer is always looking for an easy way to lose weight"

Eric Sprunk, vice-president for global product and merchandising at **Nike**, ended a speech to investors on innovation with a jab at the so-called toning shoes driving sales increases for competitors. "Wouldn't it be great if we could make a pair of shoes that made your butt smaller, made my gut look smaller, make your muscles look a little bit bigger, just by putting them on and ... walking in them?" Sprunk asked his audience on May 5. "Nobody can do that. I was just teasing."

The big market share gains that **adidas**'s Reebok unit and **Skechers USA** are getting thanks to their toning shoe lines are no joke, however. Although Nike has held on to its top spot in the U.S. woman's athletic footwear market, its share slipped 7.2 percentage points, to 31 percent, or $412 million, in the first quarter from a year ago, according to researcher SportsOneSource. Reebok's share more than doubled, to 6.7 percent,



ILLUSTRATION BY SERGE BLOCH

or $90.3 million, and Skechers tripled to 17 percent, or $225.7 million. "Nike spent months watching this thing develop and did nothing about it and now they are paying the price of a missed opportunity," said Matt Powell, a sports retail analyst at SportsOneSource.

Toning shoes are designed to simulate the feeling of walking on sand and make wearers stabilize their steps, leading to stronger leg, buttock, back, and abdominal muscles, according to Skechers, maker of the Shape-ups toning shoe. Reebok says its EasyTones generate 28 percent more gluteus maximus muscle activation than a typical walking shoe, and 11 percent more in the hamstring and calves. Both companies cite research and testing they commissioned to back up the claims.

John Pagliano, a podiatrist in Long Beach, Calif., says he gets asked about toning shoes several times a day and he doesn't recommend them. While he said the instability in the shoes causes muscles to work harder, he hasn't seen enough evidence to believe it can firm wearers' backsides. "I say I'm not really sure, and I haven't been convinced by the studies," said Pagliano, who specializes in athletic injuries.

Still, women's toners with their $100-plus prices have become some of the most lucrative footwear in the U.S. A year ago, the top 10 highest-grossing athletic shoes didn't include

HSM Inspiring ideas

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any toning shoes or women's footwear. In a May 16 survey by SportsOneSource, six of the top 10 athletic shoes were toning products: four Shape-ups and two EasyTones. Nike had the four remaining shoes, including a pair of Air Jordans that sell for $150.

Toning-shoe sales in the U.S. totaled just $17 million in 2008 but jumped eightfold, to $145 million, last year when both Reebok and Skechers introduced their models, according to NPD Group. Skechers featured its Shape-ups line in a Super Bowl commercial in February, further fueling sales of toning shoes. In the first four months of this year, toning footwear sales skyrocketed to $252 million—75 percent more than the total for all of 2009.

"The explosion of growth in this space in such a short period of time eclipses everything I have witnessed in the industry over the last 25 years," says **adidas** CEO Herbert Hainer, who said Reebok could sell 5 million pair of toning shoes in the U.S. this year.

After Reebok ramped up its ads last fall, retailer **Foot Locker** couldn't keep up with toning-shoe demand. Says Foot Locker CEO Ken Hicks: "The American consumer is always looking for an easy way to lose weight, and this proves it."

Nike wants to lure women thinking of buying toning shoes to its five-year-old Free brand, which sells for $85 and the company says simulates barefoot running to strengthen feet and muscles. It plans new versions this fall. "We're excited that women are spending money on athletic footwear, and we think we can get our share," said Charlie Denson, president of the Nike brand. Free can "supply the same kind of benefit to the athlete that maybe some of the others are claiming."

In the quarter ended Feb. 28, footwear was the only segment of Nike's North American business to post a sales decline, dropping 1 percent, to $1.2 billion, while overall revenue rallied 6.6 percent, to $4.73 billion.

"They realize it's definitely a category, and they can't ignore it," said Chris Svezia, a sporting-goods analyst at Susquehanna Financial Group. "There's probably pressure from retailers saying 'why not do it?'" Ⓑ —*Matt Townsend*

The bottom line *Despite uncertainty over their training benefits, toning shoes for women have become hot sellers for makers of athletic shoes.*

In brief



A Sasol coal-to-liquid fuel plant in Secunda, South Africa

Sasol
Banking on India's Growing Energy Needs
Sasol, the South African company that is the world's leading producer of motor fuel made from coal, plans to invest $10 billion in India under a joint venture with Tata Group. The duo plans to eventually churn out 80,000 barrels of fuel a day from a coal deposit in the eastern state of Orissa. India's energy use is projected to more than double by 2030 as rising incomes boost demand for gasoline, diesel, and other fuels. Johannesburg-based Sasol produces more than 40 percent of South Africa's motor fuel using technology first employed by Nazi scientists and refined by apartheid-era engineers. The company is also actively scouting opportunities in other fast-growing emerging markets. Sasol already operates a coal-to-fuel plant in China and recently inked a deal to build one in Indonesia.

Caterpillar
Riding the Rails of the U.S. Recovery
The world's largest maker of construction equipment agreed on June 1 to acquire a diesel-locomotive manufacturer for $820 million from Berkshire Partners and Greenbriar Equity Group. The deal represents a sizable bet on continued growth in rail transport. North American rail volume rose 8 percent in the first three months of 2010 from a year earlier and is up 18 percent year-on-year so far this quarter, providing further confirmation that the U.S. economy is on the mend.



RadioShack
Equity Players Eye an Electronics Chain
Blackstone Group is a leading bidder for RadioShack, according to a June 1 report in *The New York Post*. (Neither company would comment). Rival private-equity firms KKR, Bain Capital, and TPG may also jump into the fray, the paper reported. RadioShack has pared debt and capital spending in the last year. Profits are up, thanks to rising sales of mobile phones. The Fort Worth (Tex.) chain operates more than 6,500 outlets in the U.S. and Mexico.

Honda
Pay Hikes for Workers May Set a Precedent
Honda Motor has offered to increase the pay of workers at four Chinese car parts plants by 24 percent, after strikes forced it to shut down production in the world's biggest car market. Other multinationals doing business in China may find themselves in a similar bind. Manufacturing job growth has accelerated to the fastest pace in at least five years, according to new data from The Federation of Logistics & Purchasing. Rising wages should stoke consumption, supporting Beijing's goal of shifting the nation's economy away from exports. But one short-term consequence may be a spike in inflation.

Zipcar
Car-Sharing Startup Preps for Prime Time
Zipcar, the car-sharing company that rents vehicles by the hour, aims to raise as much as $75 million from an initial public offering. The Cambridge (Mass.)company, which has not posted a profit since it was founded in 2000, will use the proceeds from the share sale to cut debt, expand its fleet, and make acquisitions, according to a filing with the Securities & Exchange Commission. Zipcar currently operates in 13 metropolitan areas, including London, where it acquired Streetcar in April. The company has also made an acquisition in Spain and is looking to expand in Europe.

Tenet Healthcare
Opportunity Scouting Down Under
Tenet Healthcare is in talks about a possible purchase of Healthscope, Australia's second-largest hospital operator. Healthscope announced on May 31 that it received two offers of $1.5 billion but has not identified the bidders. Dallas-based Tenet, the third-largest publicly listed hospital chain in the U.S., is scouting opportunities to tap rising spending on private health care. Purchasing Healthscope could improve Tenet's margins, since under Australia's health-care system, private hospitals generally serve patients who choose to buy their own insurance or pay for hospital care.



Sony
Bringing its 3-D Business Into Focus
Sony announced that it will start offering 3D titles for its PlaySation 3 gaming console beginning June 10. Mr. Pain, Strike HD, and WipEout HD will be available for download on Sony's PlayStation Store. The releases are timed to coincide with the rollout of Sony's 3D televisions. Sony Chairman Howard Stringer (above) has said he expects 3D movies, pictures and games to be the company's next $10 billion business.



CLOCKWISE FROM TOP: PER-ANDERS PETTERSSON/GETTY IMAGES; DARIO PIGNATELLI/POLARIS; ZIPCAR/BLOOMBERG; DANIEL ACKER/BLOOMBERG



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Disposable income in Senator Reid's Nevada fell sharply in 2009

It's About Real Disposable Income, Stupid

▶ It may be a better predictor of how Democrats will fare in midterm elections than unemployment

▶ "For many households, aftertax income is still declining"

Back in 2008, before his trucking business failed for lack of freight to haul, Roman Dmytriv and his wife voted for Barack Obama. In this fall's election, they probably won't bother casting ballots. They criticize the President for helping Wall Street while doing little for ordinary people hit by the recession. "For some reason, we believed him. I feel a little bit cheated," says Dmytriv, 43, of Freehold, N.J. "Now I work in [info tech]. I live from paycheck to paycheck."

Never mind the unemployment rate. For early omens of the midterm election results, watch the amount of money going into people's pockets. In the language of economists, that's real disposable personal income per capita—the amount an individual has available to spend after taxes and adjusted for inflation. The numbers are not encouraging for Democrats.

Measured by disposable income, America's standard of living has been stagnant since January 2009, when Obama took office and Democrats tightened their grip on Congress. That's a sharp break with the historical trend: Over the past decade annual growth in real personal income per capita has averaged 1.6 percent. The only calendar years with declines during the past two decades were 2008, when the White House went from Republican to Democratic, and 1991, the year before the defeat of President George H.W. Bush.

Income growth has been the best economic predictor of U.S. Presidential election results since 1952, says Douglas A. Hibbs Jr., a former government professor at Harvard University and economics professor at Sweden's Gothenburg University. "It's the broadest measure of economic well-being," says Hibbs. "It has a very, very powerful effect." Former Labor Secretary Robert Reich puts it this way: "The underlying reality that people live with is their sense of anxiety about paying the bills."

Even lackluster growth is usually hard on incumbents. "Unemployment was falling when the first George Bush was running for reelection, and it did not stop us from running on 'It's the economy, stupid,'" says Stanley B. Greenberg, a Democratic strategist and former pollster for President Bill Clinton. "In 1994, the unemployment rate fell, but we got killed on the economy because incomes did not rise."

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ALEX BRANDON/AP PHOTO

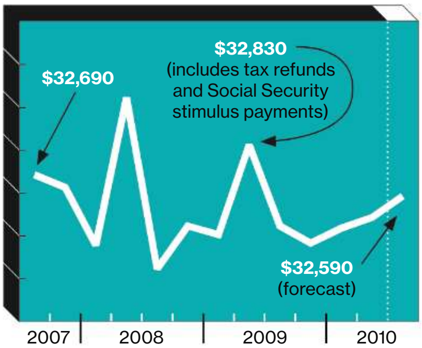
Politics&Policy

Closing computing's gender gap page 39 ▶



Lagging Income

By the end of the third quarter, real disposable income per capita is forecast not to have returned to pre-recession levels.



DATA: MOODY'S ECONOMY.COM. ALL FIGURES IN 2005 DOLLARS

It wasn't until 1995 that average aftertax income for the bottom 90 percent of earners returned to its 1992 level, according to IRS data.

In Nevada, where Senate Majority Leader Harry Reid is struggling to win reelection, the plunge in the construction and hotel industries drove down per capita personal income last year by 5.8 percent, the sharpest decline of any state other than Wyoming, according to the Commerce Dept.'s Bureau of Economic Analysis. (The agency does not collect state-level inflation data that would allow adjusting state numbers for inflation.)

For Reid and others hoping to remain in office, the lag in personal income is reason for worry, even as other indicators turn up. The overall economy has been growing since the middle of last year, and despite the recent tumult in the market, stocks have risen since Obama took office.

As the U.S. heads into the election at the end of the third quarter, real disposable income per capita will be up "a very anemic" 0.4 percent from a year earlier, forecasts Mark M. Zandi, chief economist at Moody's Economy.com. "That suggests for many households aftertax income is still declining," he says.

While it may be hard to appreciate after a jarring recession, job security is improving for most Americans. In February, more workers quit their jobs than left them involuntarily for the first time since November 2008, a trend that has since continued, according to the Labor Dept. Unemployment has remained high because companies have been slow to hire new workers. Beginning in February, layoffs have been running below the historical average since the Labor Dept. began compiling the data in 2000. That is not enough to ease people's job fears, says Dennis J. Jacobe, chief economist for Gallup. "Perceptions will take a long time to turn around because they've been built up over two years," he says. "We have to see some significant hiring. Just stopping the layoffs is not enough."

With most voters not feeling the benefits of recent growth, they tend to view economic policies through a populist frame, Greenberg says, adding that it's "demonstrably ineffective" for the White House and national Democrats to claim credit for progress on the economy. "Democrats should not run on the condition of the economy," Greenberg states. "They should run on what they've done to get the economy moving in the right direction and help the middle class through this crisis."
—*Mike Dorning*

The bottom line *The flat or lackluster real disposable income figures could spell trouble for Democrats in the midterm elections.*

Defense Spending

GE, Pratt & Whitney, and A Big-Bucks Media War



▶ **The Pentagon balks at funding GE's F-35 backup engine program**

▶ **"It's absolutely a political campaign, there's a winner and loser"**

For four years, **General Electric** has defied the Pentagon and persuaded Congress to fund a backup engine for the F-35 Joint Strike Fighter. The ongoing, $382 billion weapons program is the most expensive in U.S. history. Defense Secretary Robert M. Gates and **Pratt & Whitney**, the F-35's primary engine maker, are asking Congress not to set aside $485 million for the alternate GE engine in this year's defense budget. If that happens, GE fears it would effectively end the company's involvement in the fighter engine market, estimated at $100 billion.

What's a defense contractor to do? Answer: Borrow a page from the politicians' playbook by running millions of dollars of radio and newspaper ads. Toss in some **YouTube** videos, tweets, and **Facebook** pages. And mobilize workers and pensioners to conduct a letter-writing blitz. "It's absolutely a political campaign, there's a winner and loser here," says Evan Tracey, president of Campaign Media Analysis Group, a unit of New York-based Kantar Media.

The campaign seems to have had some effect. On May 27 the House voted to include funds for the GE backup engine in its bill authorizing defense spending. For that reason, President Obama threatened to veto the measure the next day. The Senate Armed Services Committee, on the same day as the House vote, sided with the Pentagon and left the money out. If the full Senate agrees, says Senator Carl Levin (D-Mich.), chairman of the committee, a joint House-Senate conference will resolve the matter. Last year, when there was a similar House-Senate disagreement, the Senate quietly acquiesced to the House's decision to authorize $465 million for the backup engine.

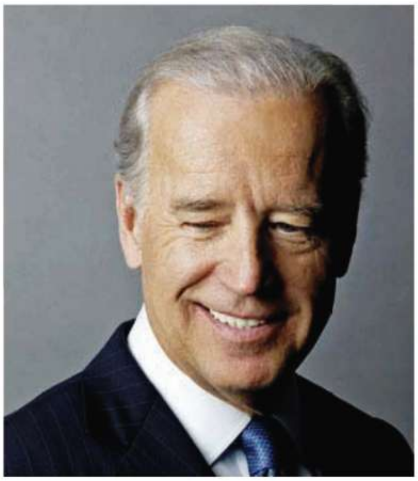
This year's Pentagon scrap began when Gates rejected funding for GE's engine, which he considers a wasteful program, in the annual budget he sent Congress in February. Gates wants to rely solely on Pratt & Whitney, whose contract lets it supply engines through 2016 to **Lockheed Martin**, the builder of the jet. Even before that date, GE hopes to persuade the Pentagon to open up competition for the fighter jet engine, ahead of hundreds of new plane orders by the U.S. and its allies.

GE says competition will force Pratt, a unit of **United Technologies**, to lower its costs and save the Pentagon money in the long run. Pratt doesn't like letting its rival get a share of the market and ran full-page newspaper ads saying that GE's engine would cost taxpayers an additional $2.9 billion, a figure

F-35: ANDY WOLFE/LOCKHEED MARTIN

Charlie Rose talks to

Vice-President Joe Biden



We are beginning to read more and more that mainly because of the oil spill, the President—as Maureen Dowd said—has lost his narrative and this Administration is looking a bit like the Carter Administration in the Iranian crisis.
First of all, I don't think they're legitimate criticisms. If there's any mistake made, [it's] that we haven't communicated clearly enough. The first morning after that well blew [the President] ... made it clear that every single asset of the federal government should be made available. He talks with such empathy about this being not merely an economic catastrophe. This is potentially going to ruin ... the unique bayou culture.

There's an ecosystem at risk.
There's an ecosystem, but also a way of life at risk. And he talks about that.

But has he talked about it in a way that has resonated with the American people?
He talked about it privately with me from the get-go. But here is what he did. He immediately authorized the call-up of the National Guard. He mobilized 20,000 paid personnel for the cleanup. He personally told the Coast Guard to go out and find every [oil containment] boom you can. He has acted swiftly.

The federal government is in charge of this rescue, not BP?
BP is not in charge. The President of the United States is in charge of this rescue.

So characterize BP's performance.
They have responded to almost every request I'm aware of—from going out and putting 20,000 people on the payroll ... to beginning to clean up where [the oil has] gone ashore. The one place that they were slow was in characterizing the number of barrels of oil spewing from that pipe.

Done the best they could?
Well, not being an oil man or an expert in this area, I think they have done the best they could.

How do you assess the success of the stimulus program in creating jobs?
Here's the best way I think to lay it out without getting into all the economic terms. When I raised my right hand on Jan. 20 [2009] ... we [were] losing 740,000 jobs for that quarter. We had a negative GDP. We were contracting at 6.4 percent. Housing prices dipped for 24, 25 months in a row. Here we are 18 months later ... GDP is actually growing. Just in the last two months we've created 500,000 new jobs. We will create over 3.5 million or save over 3.5 million jobs before this is over.

When do you see employment getting back to the level it was before we hit the skids?
It's going to take us several years to get back but ... I think we'll create 100,000 to 200,000 jobs on average all the way through this year.

So at 100,000 to 200,000 jobs per month, how long would it take to get to, say, 6 percent unemployment?
The answer to that question is unknowable. We don't know what's going to happen in Europe and what impact that could have on the international economy, the marketplace, and confidence.

I raise this because there's some talk about a new norm.
I do not buy, nor does the President, this idea of a new norm. We have to build a new economy.

Can we do it without taxation?
If you take a look at the Recovery Act, which is a lot of money, $787 billion, do you realize that by the year 2012 that will only add one half of one percent to the debt that exists? Now let's talk about the long-term debt. The biggest piece of long-term debt is entitlements. The biggest piece of that is health care. So forget the justification for the health-care bill as it relates to ... people getting access to care. In the first 10 years [after] passage of that bill, we're reducing long-term debt by $130 billion; the second 10 years, $1 trillion.

Why was it so hard to sell?
Because it's counterintuitive to say this bill is going to cost over the next 10 years roughly $80 billion to $90 billion a year ... and by the way, you're going to save money.

That would suggest to me that somebody hasn't sold it very well.
Look, we got it passed. Everybody said that there was no possibility of getting it passed. People are finding out that—God love her—Sarah Palin's death panels don't exist. People are figuring out they're not losing insurance.

All of that is true, but there is a thing called the Tea Party.
I got to be careful here because I think an awful lot of the Tea Party people are absolutely earnest. But I would say to the Tea Party people, you don't like federal government? [So] you think we should not be involved in the oil spill? It's private enterprise. Is the federal government not needed? B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

...GETTY IMAGES; BRAD TRENT

GE disputes as too high. Instead, the company says it will need $1.8 billion more to complete development work, on top of the $2.9 billion it has already received from the Pentagon.

GE attacked Pratt's program in radio and newspaper ads, citing Government Accountability Office estimates that Pratt's engine is 50 percent over budget. On May 18, the Fairfield (Conn.) company also created a Facebook page for its engine. Its 10,078 fans helped generate 36,000 letters to lawmakers, says Rick Kennedy, a GE spokesman. That doesn't include the 435 notes sent by Chief Executive Officer Jeffrey R. Immelt to all members of the House. Pratt & Whitney already had a Facebook page set up from the previous year; its 1,451 supporters assisted in sending 10,000 letters to members of Congress, says Pratt spokeswoman Erin Dick.

GE, whose engine is made in partnership with London-based **Rolls-Royce Group**, outspent Pratt in traditional media outlets, according to Tracey, who estimates that GE spent about $450,000 on ads in *The Washington Post*, *The New York Times*, *USA Today*, and *Congressional Quarterly* targeting lawmakers. Pratt likely spent about $250,000 on newspaper ads, Tracey says. GE also ran radio spots across the country, including on Washington's WTOP news station and WBT, the Charlotte (N.C.) news talk station.

Overall, GE has spent "millions of dollars" on the campaign, including radio and print ads in Michigan, Ohio, Massachusetts, and Indiana, Kennedy says, declining to give a specific amount. The campaign was in part to alert employees and pensioners across the country in states where the company has large operations. Pratt spokeswoman Dick also declined to say how much it spent, except that it was likely less than General Electric.

GE is mobilizing its army of 134,000 U.S. employees and the 635,000 current and former workers covered by its pension plans. The aim is to drum up enough congressional support for the defense measure–and avert a Presidential veto. —*Gopal Ratnam, Rachel Layne, and Tony Capaccio*

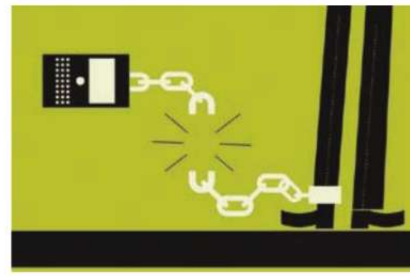
The bottom line *GE has adopted a political-style campaign to persuade Congress to continue funding the F-35 backup engine—and it just may work.*



Lockheed Martin's F-35 fighter jet production line in Fort Worth

Regulation

At the SEC, a Pushback Against 24/7



▶ The SEC enforcement lawyers' union balks at BlackBerrys

▶ "It wouldn't be fair to characterize employees as lazy"

Robert Khuzami, the ex-**Deutsche Bank** lawyer running the enforcement shop at the Securities & Exchange Commission, is winning kudos for bringing civil fraud charges against **Goldman Sachs** and helping repair the agency's tattered image after missing Bernard Madoff's $65 billion Ponzi scheme. Yet the deep cultural chasm between Wall Street and Washington has occasionally tripped him up.

Khuzami in January announced a plan to hand out BlackBerry smartphones to his staff to keep everyone in the loop about current cases. Yet the labor union that represents the division's mostly law school-educated employees–yes, there is one–balked. Concerned that staff would be chastised for not responding to midnight e-mails, the National Treasury Employees Union said the devices should go only to those SEC employees who requested them.

Intense negotiations followed, and a compromise was struck: Almost every worker would get a BlackBerry, but they could be turned off after normal work hours and on weekends. "We just don't think employees should be expected to be on call 24/7," says Greg Gillman, a Boston enforcement attorney who serves as the local union president. "It wouldn't be fair to characterize employees as lazy," adds Gillman, who represents almost every SEC nonmanager whether they sign up for the union or not.

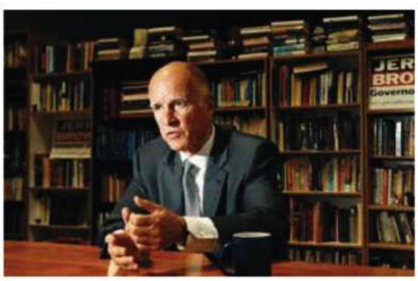
FROM TOP: ILLUSTRATION BY GREG MABLY; COURTESY OF LOCKHEED MARTIN

Khuzami plans to issue 294 BlackBerrys by the end of July. The SEC believes employees will "welcome the device because it's vital that enforcement staff have all the tools they need whenever they're called upon to pursue wrongdoing," says SEC spokesman John Nester. That is, as long as "whenever" doesn't fall after 5 p.m. or on a Saturday. —*Jesse Westbrook*

The bottom line *SEC enforcement lawyers will be issued BlackBerrys and, under union rules, will be allowed to turn them off once they clock out.*

State Politics

Can Jerry Brown Cut California Down to Size?



▶ **To cut the deficit, Brown may need to stand up to state unions**

▶ **"I don't think he wants to end his career as Governor Moonbeam"**

He's a master of political reincarnation. Can Jerry Brown, first elected governor of California in 1974 at the age of 36, double back to Sacramento and revive a state economy with the lowest bond rating in the U.S. and an unemployment rate clocking in at 12.6 percent?

With the state facing its third year of multibillion-dollar budget deficits—the gap for the fiscal year starting on July 1 is $19.1 billion—California's gubernatorial election is shaping up to be a referendum on who has the best strategy for fixing the Golden State's $1.8 trillion economy. The 72-year-old Brown, the state's attorney general and a Democrat, faces no serious challengers within his own party. He's also leading his potential Republican opponents, former **eBay** Chief Executive Officer Meg Whitman and state Insurance Commissioner Steve Poizner, a onetime Silicon Valley executive, according to a May 29 University of Southern California/*Los Angeles Times* poll. Brown led Whitman, 44 percent to 38 percent, and Poizner, 45 percent to 31 percent.

When it comes to understanding the intricacies of governing, few can match Brown's résumé. He served as California's secretary of state, governor for two terms, and mayor of Oakland. "The state is very messed up," Brown said in a June 1 interview. "The issues that we are facing are in some ways eerily similar to ones that I was focused on as governor. My central message then was that we were in an era of limits."

Whitman, who leads Poizner going into the June 8 Republican primary, says she'll cut business taxes, slash 40,000 state workers, and put future hires into 401(k)-like savings plans to cut pension costs. Brown says he would favor increasing retirement ages or workers' contributions to pensions but not elimination of state retirement plans. Overall he is vague on his policy.

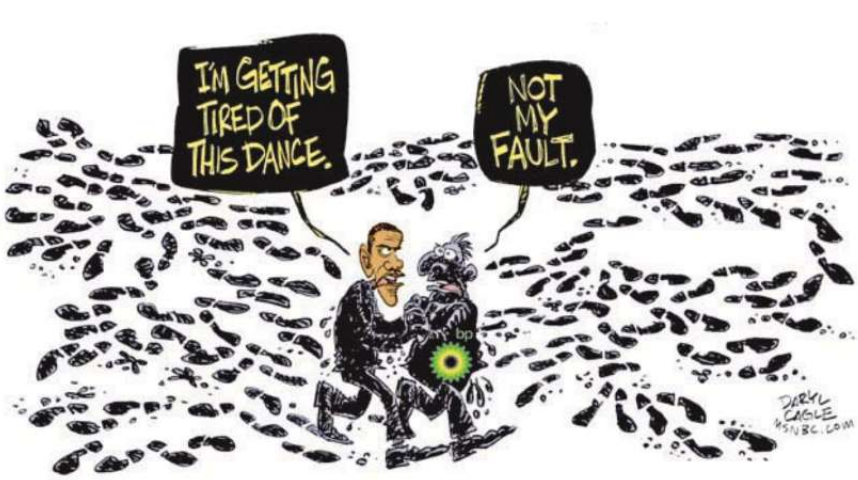
One immediate challenge for Brown: how to compete in fund-raising with Whitman and Poizner, both of whom can draw from personal fortunes. Brown has raised $20 million so far, according to public records, less than a third of what Whitman has already spent in the primary. The state's labor unions are worried enough about a potential Whitman victory that they're forming independent committees to raise funds and run Whitman attack ads.

One, the California Working Families 2010 committee, is sponsored in part by the Service Employees International Union, the California Professional Firefighters, and Los Angeles investor Ron Burkle. It hopes to spend at least $30 million to portray Whitman as a heartless job slasher with Wall Street ties who'll give tax breaks to rich friends.

The heavy reliance on union money will make putting Sacramento's financial house in order tricky if Brown prevails. True, Brown's frugality is well known. As governor in the '70s, he shunned the official mansion and predecessor Ronald Reagan's Cadillac limousine in favor of a two-bedroom apartment across from the capitol and a state-issued Plymouth Satellite. "He reduced salaries when he came to office," says Gray Davis, who served as Brown's chief of staff in the 1970s and was ousted as governor in a 2003 recall. "He will perform as necessary."

When Brown ran California, state spending doubled during his eight years in office, though it increased at a higher rate under Reagan. The state's workforce, as a percentage of California's total population, actually shrank. He ran surpluses early in his administration, but the 1982 recession resulted in deficits. Whitman, who plans to spend $150 million to win the election, has already been criticizing Brown as a tax-and-spend liberal who set the stage for public-sector bloat by signing legislation in the 1970s that gave teachers and state workers the right

Drawing Board



FROM TOP: NOAH BERGER/BLOOMBERG; ILLUSTRATION BY DARYL CAGLE/MSNBC.COM/CAGLE CARTOONS

to bargain collectively. "She's going to run a very classic, Reaganesque campaign," says Whitman's chief campaign strategist, Mike Murphy. "We are going to be getting everybody who is tired of the Sacramento political system that Jerry Brown is the alpha-male dog of." The California Chamber of Commerce has already produced an ad criticizing Brown for his early opposition to the 1978 Proposition 13 voter initiative, which limited the growth in property taxes, and his spending record as Oakland mayor.

That said, Brown does have admirers in the business community. Martin J. Wygod, the chairman of New York-based **WebMD Health** and an independent, says he recently hosted a lunch meeting between Brown and Gerald L. Parsky, a Los Angeles money manager who chaired a commission on tax reform for Republican Governor Arnold Schwarzenegger. The two talked about ways to reconfigure the state's tax structure for nearly four hours. "He only has one agenda, which is to try to help the state," Wygod says of Brown.

Some think Brown's long record of public service, a negative across much of the country this year, will actually be a plus in California, where a charismatic figure like Schwarzenegger couldn't deal effectively with a legislature controlled by Democrats. "If Arnold couldn't deal with this legislature, given his personality and being a moderate Republican, I don't know how Meg Whitman could really govern," says Los Angeles billionaire Eli Broad, a longtime Democratic Party supporter.

Rick Caruso, a Republican mall developer in Los Angeles, says he is supporting Brown because he is the candidate most likely to make positive changes. "I don't think he wants to end his political career as Governor Moonbeam," Caruso says, referring to Brown's '70s-era nickname.

Brown says one of his biggest qualifications is that he truly wants the job. "These wannabe governors have Potomac fever," says Brown, who ran for President unsuccessfully three times. "I have been there myself." —*Christopher Palmeri and Michael Marois*

The bottom line *Brown's efforts to portray himself as a centrist won't go unchallenged by California Republicans who call him a tax-and-spend Democrat.*

Financial Regulation

One Exec's Plea to Congress: Regulate Me



▶ **Congress isn't eager to oversee the fraud-prone industry**

▶ **"Hard to fathom," given "all this financial regulation"**

As Wall Street bankers try to squirm out of stricter oversight from financial regulatory legislation now wending through Congress, Michael Halloran is taking the opposite tack. Halloran is the chief executive officer of **NES Financial**, whose **Nationwide Exchange Services** unit in San Jose, Calif., sets up and manages escrow accounts that hold funds for property sales, ranging from real estate to corporate aircraft. Halloran or his lobbyists have spent the past 18 months meeting with more than 100 lawmakers, urging them to regulate his industry.

Surprisingly, his crusade so far has come to naught, despite a spike in fraud cases over the past couple of years in which consumers have been ripped off by firms that looted funds or invested in risky securities that went kaboom. "It's hard to fathom when you are looking at all this financial regulation and you're saying, 'Please regulate us,' that you can't get it done," says Halloran.

Specifically, Halloran wants closer oversight of his industry, which handles so-called 1031 exchanges, named for the section of the U.S. Tax Code that allows property sellers to defer capital-gains taxes if they give their funds to a "qualified intermediary" (an escrow agent) and buy something similar within six months. Halloran wants Congress to require the firms to keep client money in segregated Federal Deposit Insurance Corp.-insured accounts and submit to an annual audit. The Federation of Exchange Accommodators, a trade group representing 150 companies, is also pushing for federal regulation, though the group differs with Halloran on the details.

Only eight states regulate these qualified intermediary companies, which is inadequate, says Representative Mike Michaud (D-Me.), author of the provision calling for stricter industry oversight that made it into the House bill. "We need appropriate protections in place nationwide," Michaud says. New Jersey resident Rosanna Passantino wouldn't quibble with that: She lost $351,570 in savings when a firm she entrusted money to went bust. "We need to have these laws passed," she says.

The Senate financial overhaul bill calls for no industry oversight. So Halloran is pressing hard to get the escrow provision into the final House-Senate bill, expected to hit the President's desk by July 4. Turns out persuading Congress to regulate your industry is hard work. B —*Robert Schmidt*

The bottom line *Congress isn't eager to expend much energy passing new rules for the escrow firms, a niche industry too obscure to grab headlines.*

Quoted

"I worked for half a year to try and move the bases off Okinawa, but wasn't able to do so." —Yukio Hatoyama, in resigning as Prime Minister of Japan on June 2, after just nine months in office and having broken a campaign promise to move U.S. troops



FROM TOP: PHOTOGRAPH BY GABRIELA HASBUN FOR BLOOMBERG BUSINESSWEEK; EPA/ZUMA PRESS

James Warren

Cough If You Need Sick Leave



Americans shouldn't have to work when sick or lose pay, but is the aftermath of the Great Recession the right time to add another new business cost?

The short, lumpy red couch in Stili Klikizos' second-grade classroom at Milwaukee's Fratney Elementary School was meant for quiet-time reading. Now it's "the sick couch," a place for ill students to lie down as they await the bus that takes everybody home at day's end. "The parents work and will lose pay if they come get them," she told me as I sat on the couch. Thanks to her union contract, Klikizos gets 12.5 paid sick days a year. Many of her students' parents aren't so fortunate. "It crosses socioeconomic lines. Sometimes kids tell me not to even call, since 'Mom will get fired if she leaves.'" Last year, several couch-sitters were belatedly diagnosed with swine flu.

The no-show parents are among the 40 percent of the private sector who don't receive sick pay. Among full-time workers, 73 percent are covered by paid medical days. (Ninety-one percent have paid vacation, 89 percent paid holidays). The percentage is far lower on every count for part-time workers, though it's not just the motel cleaning lady or immigrant dishwasher who is scared to call in sick, see a doctor, or pick up a kid from school. Retail sales supervisors and information technology managers deal with the same domestic crises.

They all have a stake in the little-noticed debate over paid sick days now unfolding in Washington, state capitals, and cities, with strong arguments for change confronting the economic and political realities of a recession that makes employers nervous about any extra costs. In Congress, the proposed Healthy Families Act—one of the last bills sponsored by Massachusetts Senator Ted Kennedy before he died—would guarantee as many as seven paid sick days a year for workers at companies with at least 15 employees. More than 30 million additional workers would be covered if it passes, including 6 million food-service and food-preparation workers who now have to either work when sick or lose pay. Consider that next time you're dining out.

Similar state and local proposals are launching debates in Connecticut, Massachusetts, and New York City. Laws are already in force in San Francisco and the District of Columbia, with the constitutionality of Milwaukee's soon to be argued in the Wisconsin Supreme Court. The face-offs echo those surrounding the Family & Medical Leave Act signed by Bill Clinton in 1993, with one side invoking morality and practicality and the other warning of dire economic consequences. The FMLA allows workers to take up to 12 weeks of unpaid leave to deal with a serious health problem, birth or adoption of a child, or care for a family member. Its impact has been decidedly benign.

Under a city ordinance that passed in 2008, Milwaukee workers would be eligible for up to five sick days a year if privately employed in a business of fewer than 10 workers, and up to nine days at larger firms. An employer that already provides paid leave, notably personal days or vacation, might get a pass. Still, the Metropolitan Milwaukee Association of Commerce insists the change would kill jobs "by making Milwaukee a high-cost island in which to do business." It doesn't acknowledge the possibility that new employer costs might be outweighed by reduced turnover and recruitment expenses.

The proposed Healthy Families Act would give 30 million workers up to seven paid sick days a year

In San Francisco, both the Chamber of Commerce and the Golden Gate Restaurant Assn. had similar qualms before its law took effect in 2007. Kevin Westlye, the association's executive director, says members assumed that, given the city's high minimum wage ($9.79) and mandated health insurance, paid sick leave was "strike three." The first two mandates still rankle, but paid sick days "is the best public policy for the least cost. Do you want your server coughing over your food?" The nightmare vision restaurateurs had of organized sickouts and staffers splitting "to go see the Giants play on a Friday," he says, hasn't panned out.

There's a pattern here. Washington declines to raise the federal minimum wage during hard times, and states tend to go ahead and do so. There's no question that the aftermath of the Great Recession is a tricky time to impose new costs, even if this is the right move for fairness and public health. It's a mistake for cities to "undertake a social justice agenda" and "ideologically impose" such mandates, says Kathryn S. Wylde, president of the Partnership for New York City, which represents major businesses. She's convinced of ill effects from the pending New York City proposal yet doesn't deny a popular allure. There's a certain inevitability to paid sick leave; as even Wylde concedes, "Who can argue that somebody should be cooking in a restaurant with a contagious flu?" Let the lumpy red couch in Milwaukee be used for reading, not recuperating. B





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Technology



Workers in Foxconn's vast factory complex in Shenzhen

BOBBY YIP/REUTERS

Life and Death At the iPad Factory

▶ **A suicide outbreak at Foxconn has unsettled customers like Apple and Dell**

▶ **"I do the same thing every day," says one worker. "I have no future"**

Terry Gou says he has no idea why so many of his employees are killing themselves. Gou is the founder and chairman of **Foxconn**, the world's largest electronics contract manufacturer—the maker of iPhones and iPads for **Apple**, computers for **Dell**, and countless other devices for well-known high-tech customers around the world. So far this year, 10 Foxconn workers have committed suicide. "From a logical, scientific standpoint, I don't have a grasp on that," Gou told reporters on May 27 at a press conference at the company's vast production facility in Shenzhen, China. "No matter how you force me, I don't know."

Ask around among the more than 250,000 workers at the Shenzhen complex, and you'll find explanations. One 21-year-old assembly-line worker, who asked that his name not be used, says conditions at Foxconn make his life seem meaningless. He says conversation on the production line is forbidden, bathroom breaks are kept to 10 minutes every two hours, and workers get yelled at frequently.

No one disputes that Taipei-based Foxconn, also known as Hon Hai, has cultivated a tough culture. The company generates more revenue in a year than Apple, Dell, or **Microsoft**. It has grown in profitable obscurity to become an industry juggernaut for a simple reason, says Pamela Gordon of Technology Forecasters, a supply-chain research firm: "It's the prices. Their prices are lower for high-quality work." Foxconn won Apple's order to make the iPhone after Gou directed the business units that make components to sell parts at zero profit, according to two people familiar with the chairman's actions. Net income jumped 37 percent in 2009 to $2.3 billion, Foxconn's second-best year on record.

Apple, Dell, and **Hewlett-Packard** have all announced intentions to look into Foxconn's working con-

Technology



Christie's big Hong Kong auction page 46 ▶

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PETAFLOPS

Speed of China's Nebulae supercomputer, ranked as the world's second-fastest. One petaflop equals a quadrillion calculations per second.

ditions. "We're all over this," Apple's Steve Jobs said at a tech conference on June 1. He called the suicides at Foxconn "very troubling." Apple, HP, and Dell declined to comment on specific actions they planned to take.

Gene Grabowski, who chairs the crisis and litigation practice at Levick Strategic Communications, says this could be a Nike moment for tech companies, referring to the public outcry in the early 1990s over working conditions at Asian shoe factories. He says one way to minimize any Foxconn-related PR trouble would be to follow the strategy of U.S. toymakers. In 2007, after their Chinese manufacturing partners were found to be allowing lead paint into products sold in the U.S., companies sent inspectors to watch over the plants and invited national media to monitor improvements. "It sent a signal to the Chinese companies that their work was being constantly monitored, and it reassured families around the world that toy manufacturers had got the message," says Grabowski.

Gordon, the supply-chain expert, says it would be hard for a tech company to switch from a partner the size and sophistication of Foxconn. "Separating from a contract manufacturer can be painful," she says, because of the complexity of reworking assembly lines and supply chains. A divorce would be especially difficult for Apple, given that it's already behind in producing its hit iPad tablet computers. "They just passed two million iPads sold in less than 60 days," she says. "People are already in line. If they were to phase out Foxconn, the lines would be longer."

Meanwhile, work goes on in Shenzhen. Foxconn's facility is three square kilometers (1.16 square miles) and is crisscrossed by tree-lined streets with a fountain at the center. There's a hospital and a collection of restaurants. Workers live in dormitories, eight to ten people to a room. The company provides worker counseling, according to supervisor Geng Yubin. "For many of the young people who are here, this is the first time they've been away from home," Geng says. "Without their families, they're left without direction. We try to provide them with direction and help."

Foxconn says it's taking other steps to get the situation under control. It has installed netting around outdoor stairwells of dormitory buildings to prevent people from jumping. Workers will also be getting a 30 percent raise. The additional money may not be enough to prevent further tragedies, says Xiao Qi, a college graduate who works at Foxconn in product development. He earns 2,000 yuan a month, or $293, more than twice as much as a line worker. "I do the same thing every day," says Xiao, who says he has considered suicide. "I have no future." *—Stephanie Wong, John Liu, and Tim Culpan, with Peter Burrows, Connie Guglielmo, and Douglas MacMillan*

The bottom line *Foxconn's suicides are a reminder of the human cost that can come with the low-cost manufacturing U.S. tech companies demand.*

Strategy

Microsoft's Latest Gadget Gamble

▶ As it launches a cool video game box add-on, some investors ask why

▶ "The stock would go up if Microsoft exited its consumer businesses"

On June 15, at a video game convention in Los Angeles, **Microsoft** will unveil a little box of outsize importance. Code-named Project Natal, the device will be an add-on to Microsoft's aging Xbox 360 game console, which has shipped 40 million units in five years. Xbox sales have been slowing since **Sony** cut the price of the PlayStation 3 console last summer, but Microsoft hopes Natal will revive the Xbox—because it let users play games without a controller. Just drive your pretend car or swing your virtual baseball bat and Natal, which sits in front of the TV and has built-in sensors, picks up the motion. Following the event in L.A., Microsoft is launching an ad blitz leading up to a consumer release in October.

Microsoft needs Natal—or whatever it's called by the time it goes on sale—to be a hit. The technology is inarguably cool, and is a rare bright spot in Microsoft's decade-old—and thus far mostly disappointing—push to move

Microsoft's Imitation Creation

The "Natal" Xbox add-on detects movements and expressions so users can play games without controllers.

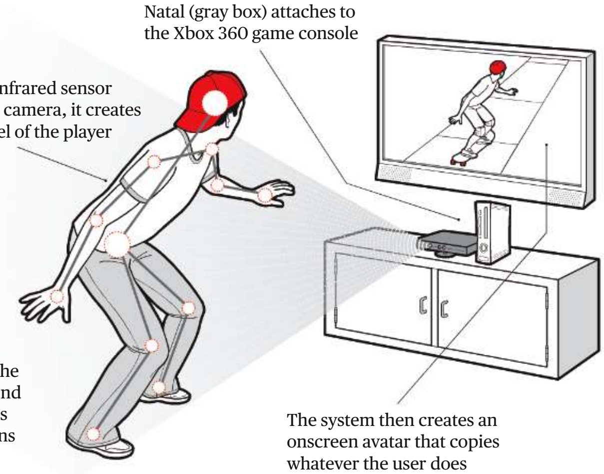


ILLUSTRATION BY KATE FRANCIS

beyond PCs and into game consoles, music players, and smartphones. Operating income at its Entertainment & Devices unit, which is responsible for those products, is expected to come in at $773 million for the year that ends June 30, according to UBS Securities. That's a 10 percent operating margin, compared with 72 percent for Windows, its most profitable business. While the Xbox is a strong No. 2 in the video game market (after the Nintendo Wii), the entertainment division has lost $8.6 billion on sales of $49 billion since 1999, estimates Katherine Egbert of Jeffries & Co. An initiative to build Internet-based TV systems has yet to take off, and its iPod-like Zune music players have bombed. While **Apple** just sold its two millionth iPad, Microsoft recently scrapped a tablet code-named Courier. In smartphones, Microsoft's share in the first quarter was 6.8 percent, down from 10.2 percent the year before.

The Natal device, which is expected to retail for about $100, won't sell in volumes high enough to matter much financially for the world's largest software company. But since it works with the current Xbox 360 console, it could reinvigorate sales of that device. That means Microsoft could put off having to field a new console, which would lose hundreds of millions of dollars for a few years; profits come from higher-margin sales of games it creates such as the Halo franchise, as well as its cut on Xbox titles made by other companies. Natal could also fuel greater interest in Microsoft's most impressive consumer play, the Xbox Live online service. More than 23 million gamers use it to play each other over the Net, as well as to download movies and music.

If Natal takes off, Microsoft might be able to extend its reach into other platforms. It could be built into PC monitors and big-screen TVs, allowing consumers to control those devices by speech or motion, moving family photos the way Tom Cruise moved pictures and videos around in *Minority Report*. Forrester Research analyst Sarah Rotman Epps envisions families synching their Natal-based Xbox console with Windows-based tablets such as the new model just announced by **ASUSTeK**, so each family member could easily download movies or books. "That would make Microsoft relevant for the next decade," she says.

Even as the company hypes Natal and its new mobile software, Windows Phone 7, investors don't expect smash hits; in fact, they'd settle for small losses on these and other gadgets. "It's hard to make the case this has been a good use of shareholder capital," says Todd S. Lowenstein, who runs HighMark Capital's value fund. "I don't fault them for trying this stuff, but investors are getting impatient." Other investors suggest that, like IBM a decade ago, Microsoft should refocus its efforts on its massively profitable PC and corporate software businesses. Its cash from operations last quarter alone was $7.4 billion, a company record. Yet its shares are down about 50 percent since Steve Ballmer took over as CEO on Jan. 13, 2000. "The stock would go up if Microsoft exited its consumer businesses," says Bill Whyman of ISI Group.

Whyman knows Microsoft won't give up on entertainment. The company has long poured money into maturing markets from word processing to Web browsers, beating market pioneers by underpricing them into submission. "Ballmer's answer is always, 'We'll keep coming,'" says Whyman. "That's not a very comforting answer." —*Peter Burrows, Dina Bass, Adam Satariano, and Cliff Edwards*

The bottom line *Despite pressure from investors and a flat stock price, Microsoft will keep searching for hits in games, phones, and other devices.*



Bowman says MLBAM is a moneymaker for the 30 big-league teams

KEVIN COOLEY/REDUX

Digital Media

Baseball Has the World Cup Covered

- **Major League Baseball's online unit will stream live soccer feeds**
- **It "has become the technology leader in the sports industry"**

When the World Cup kicks off in South Africa on June 11, many U.S. fans will be watching on Major League Baseball's Internet technology. **ESPN**, which will show the matches online, has contracted with the league's digital venture, **MLB Advanced Media**.

Launched 10 years ago to provide live baseball telecasts over the Net, MLBAM has moved beyond the national pastime. It provides streaming of CBS's March Madness and its Masters golf tournament. Joseph Inzerillo, MLBAM's senior vice-president for multimedia and distribution, says the number of people watching the Cup online may surpass 1 million. He says MLBAM can handle more than 2 million streams at a time. "MLBAM has become the technology leader in the sports industry," says former CBS Sports President Neal Pilson, who advises sports leagues on media. "They have the latest and best technology, the most experienced man-

Technology

power, and huge excess capacity.”

The company runs out of the monitor-jammed sixth floor of a former warehouse in New York’s Chelsea. On a recent day in the control room, engineers peered at a wall of screens, preparing to stream video for that night’s 15 Major League Baseball games. Each game requires two feeds, one to the home team’s fans, the other to the visitor’s. Users pay up to $119.95 to watch a season of games. For viewers already receiving ESPN as part of their cable TV package, there will be no fee to watch Cup matches online. The subscription income will be the biggest chunk of MLBAM’s more than $500 million in sales this year, says Chief Executive Officer Bob Bowman, a former ITT president. Revenue is up 20 percent over last year, according to Bowman.

Bowman says MLBAM pays annual dividends to the league’s 30 teams, who have shown no interest in either selling the company or taking it public. “They like what we’ve built,” he says.
—Ronald Grover, with Anthony Palazzo

The bottom line *MLBAM is growing 20 percent a year as it streams video for basketball, golf, and other sports.*

Intellectual Property

Fighting Over the Smarts in Smartphones

▶ Industry players are lobbing patent suits at one another

▶ “This landscape looks like France in 1914”

A brawl has broken out among cellphone manufacturers, but it’s consumers who may wind up with the black eye. **Apple**, **Microsoft**, Taiwan’s **HTC**, and others are demanding royalties from or suing players across the industry over patents on smartphone technologies. Buyers of cell phones could face higher prices if handset makers end up having to pay more in licensing fees.

Apple has launched or been the target of 23 patent suits so far this year, according to data compiled by Bloomberg. On May 7, **Nokia** sued Apple claiming that the iPhone and iPad violate several of its patents. It is one of five suits and countersuits the two companies have exchanged in the past eight months. In March, Apple sued HTC, alleging it has infringed on 20 Apple patents for touchscreens, menu controls, and other technologies. On May 12, HTC responded, asking for a halt of sales of iPhones, iPods, and iPads in the U.S., arguing that the devices use HTC technology. “This landscape looks like France in 1914,” says Eben Moglen, a professor at Columbia Law School.



Nokia and Apple have sued each other over smartphone patents

The hostilities are caused in part by the shifting boundaries between cell phones and computers, which now perform many of the same tasks. “Whenever industries merge, there may be patent litigation,” says Gustav Brismark, vice-president for patent strategy and portfolio management at Ericsson.

Manufacturers whose phones are powered by **Google**’s Android software have been hit hard by patent battles. (Google itself has not been sued.) Android handsets accounted for 28 percent of U.S. smartphone sales in the first quarter, vs. Apple’s 21 percent, according to NPD Group. Apple has filed a complaint with the International Trade Commission, saying several HTC Android phones infringe on its patents. It is also suing HTC in federal court in Delaware. Both companies declined to comment.

Licensing fees now represent less than 10 percent of smartphones’ production costs. Yet one Android handset maker has already budgeted for its patent royalty payments to double next year, says an executive, who spoke on condition of anonymity. One beneficiary may be Microsoft, which has blanketed the industry with letters demanding royalties for technologies such as touchscreen menus. “Technology just doesn’t appear, fully developed, out of Zeus’s head,” Microsoft Deputy General Counsel Horacio Gutierrez wrote in a blog post. “It requires lots of hard work and resources to create.” *—Olga Kharif*

The bottom line *An outbreak of lawsuits could crimp handset makers’ profits and may raise prices for consumers.*

Internet Scams

Click Laundering: The Latest Online Con

▶ Microsoft says RedOrbit inflated traffic via bogus third-party sites

▶ “We’re facing a much bigger problem” with this kind of fraud

Click fraud has been a scourge since the dawn of online advertising. Dishonest website operators have pumped up ad revenues by generating online traffic when there’s no actual interested buyer for the product or service being advertised. There have been plenty of varia-

Drawing Board



ILLUSTRATION BY FREDERICK DELIGNE/NICE-MATIN FRANCE/CAGLE CARTOONS

tions of that theme over the years. Big ad network operators such as **Google** and **Microsoft** have developed fraud detection systems to weed out useless clicks, to maintain the confidence of advertisers in their systems. Yet online con games keep growing more sophisticated.

Which leads to the latest trend in online advertising fraud, dubbed "click laundering" by Microsoft. On May 17, it filed a lawsuit in U.S. District Court accusing science news site **RedOrbit** of generating invalid clicks from bogus third-party sites it controlled. In early 2009, Microsoft alleges, RedOrbit founder Eric Ralls used technological trickery to make false clicks seem like they were from his site and were legitimate. (Microsoft likens it to money laundering in which financial transactions turn cash proceeds from a crime into legitimate funds.)

According to court documents, in late 2008 RedOrbit had been approved as a member of Microsoft's adCenter network, which provides pay-per-click ad services. Microsoft says Ralls manipulated tiny bits of Microsoft-generated software code so that ads appearing on other sites he controlled were clicked on and wrongly credited to RedOrbit. Microsoft also alleges that Ralls distributed software (or "malware," as in malicious software) that infected consumers' PCs and instructed them to repeatedly–and invisibly–click on ads hosted on those other sites. As a result, click traffic surged at RedOrbit.

Ralls denies all charges. In a statement, he says RedOrbit gave all of its server logs to Microsoft when the latter became concerned about a sudden spike in traffic in January 2009, and later stopped using adCenter. While Microsoft pegs the fraud at $250,000, Ralls says RedOrbit never received any money from Microsoft. "RedOrbit does not, nor has it ever, engaged, assisted in, or condoned click fraud," he writes.

Big ad networks will face challenges ensuring the legitimacy of their traffic to advertisers if click laundering becomes a pervasive trend. Should well-known websites start tapping into fraudulent clickstreams without raising suspicion, says Richard Boscovich, a senior attorney at Microsoft, "We're facing a much bigger problem." B —*Peter Burrows*

The bottom line *Microsoft and Google need to stay vigilant to keep up with ever more sophisticated click fraud schemes.*

Innovators

Sep Kamvar, Angie Schiavoni



PHOTOGRAPH BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK

A techie couple—he's a former Googler, she's a self-taught programmer—is trying to close the gender and socioeconomic gap in computing

When Sep Kamvar showed his newest batch of students how to color the text on their Web pages purple, they jumped up and squealed. The Stanford consulting professor and former Google executive has been seeing a lot of that lately. His students are 10- and 11-year-olds at Girls Prep Middle School, a New York City charter school that serves mostly low-income families.

Kamvar and his wife, Angie Schiavoni, recently launched CodeEd, a pilot program to introduce fifth-grade girls to computer science. Funded with $20,000 donated by the couple, it's the only such program in the U.S. geared to underprivileged preteen girls. "We're doing this because we saw a gender gap and a socioeconomic gap in computing," explains Kamvar. The National Center for Women & Information Technology says 18 percent of computer science degrees awarded in 2008 went to women. Only 1 percent of girls who took the SAT in 2009 said they planned to major in the subject. This puts girls at a disadvantage in the global workplace, says Schiavoni, because "many of the new jobs being created are in the technology sector."

Schiavoni, 29, taught herself programming while working for Emily's List, a group that supports women political candidates. She has since started her own consulting firm. Kamvar, 32, who has a PhD in computer science from Stanford, started a Web search firm and sold it to Google in 2003. His Iranian-born parents and his sister also have PhDs in computer science.

CodeEd is divided into five-week blocks of one-hour Saturday sessions. Each girl is loaned a Dell laptop and builds a website that becomes increasingly dynamic as the weeks go by. Most of the budding programmers are creating fan sites for heartthrob Justin Bieber.

The first session, which began on May 8 with 10 students, is an introduction to the programming language HTML. After the fifth session, the students may continue with blocks focusing on other languages such as JavaScript, commonly used to add simple games and other interactive features to websites.

Kamvar and Schiavoni, who divide their time between San Francisco and New York, plan to expand the curriculum through high school. They're already in the process of hiring teachers to bring CodeEd to more New York schools, then to other areas around the country.

Kimberly Morcate, principal of Girls Prep, says she hopes to make CodeEd a part of the regular curriculum."I suspect that learning about programming will have a ripple effect," she says. "It will get the girls wondering how other things are made, and they will come away from this class knowing how to be creators. It will open up a whole new world." —*Caroline Winter*

Résumés ▶ Kamvar sold his firm to Google; Schiavoni worked for Emily's List

Growth plan ▶ Begin in New York City public schools, then East Palo Alto

Sideline ▶ Kamvar's interactive art has been shown at New York's MoMA

Contents ▶ Sports M&A's main man 42 ▶ China's defiantly strong IPO market 43 ▶ Retail investors: Lured by options trading 44 ▶ Michael Cohrs' bittersweet exit from Deutsche Bank 45 ▶ Bid&Ask: Christie's marathon art auction in Hong Kong 46 ● Edited by Eric Gelman

Markets&Finance

Wall Street Takes Another Look at the Hard Sell

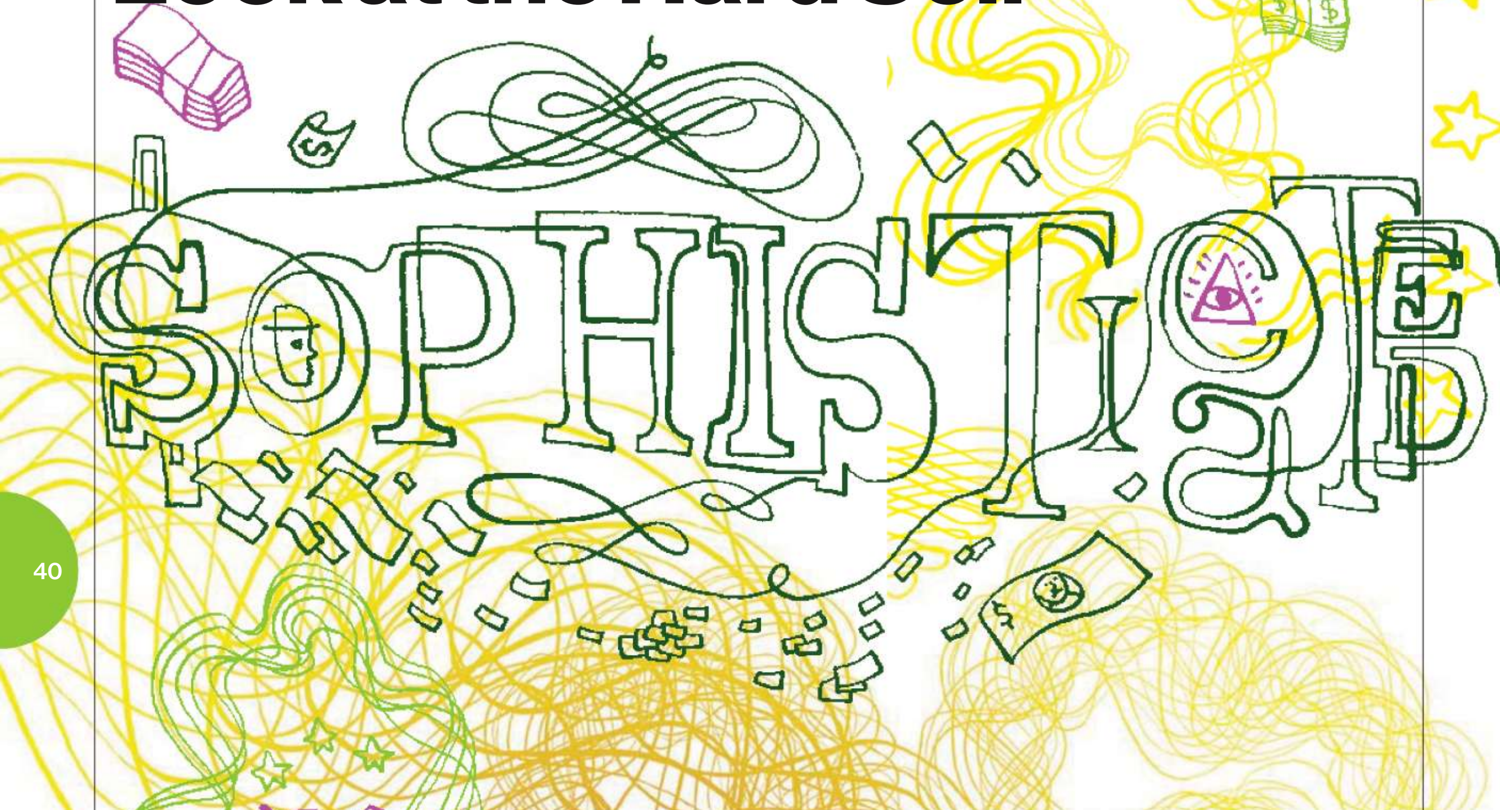


ILLUSTRATION BY BEN WEEKS

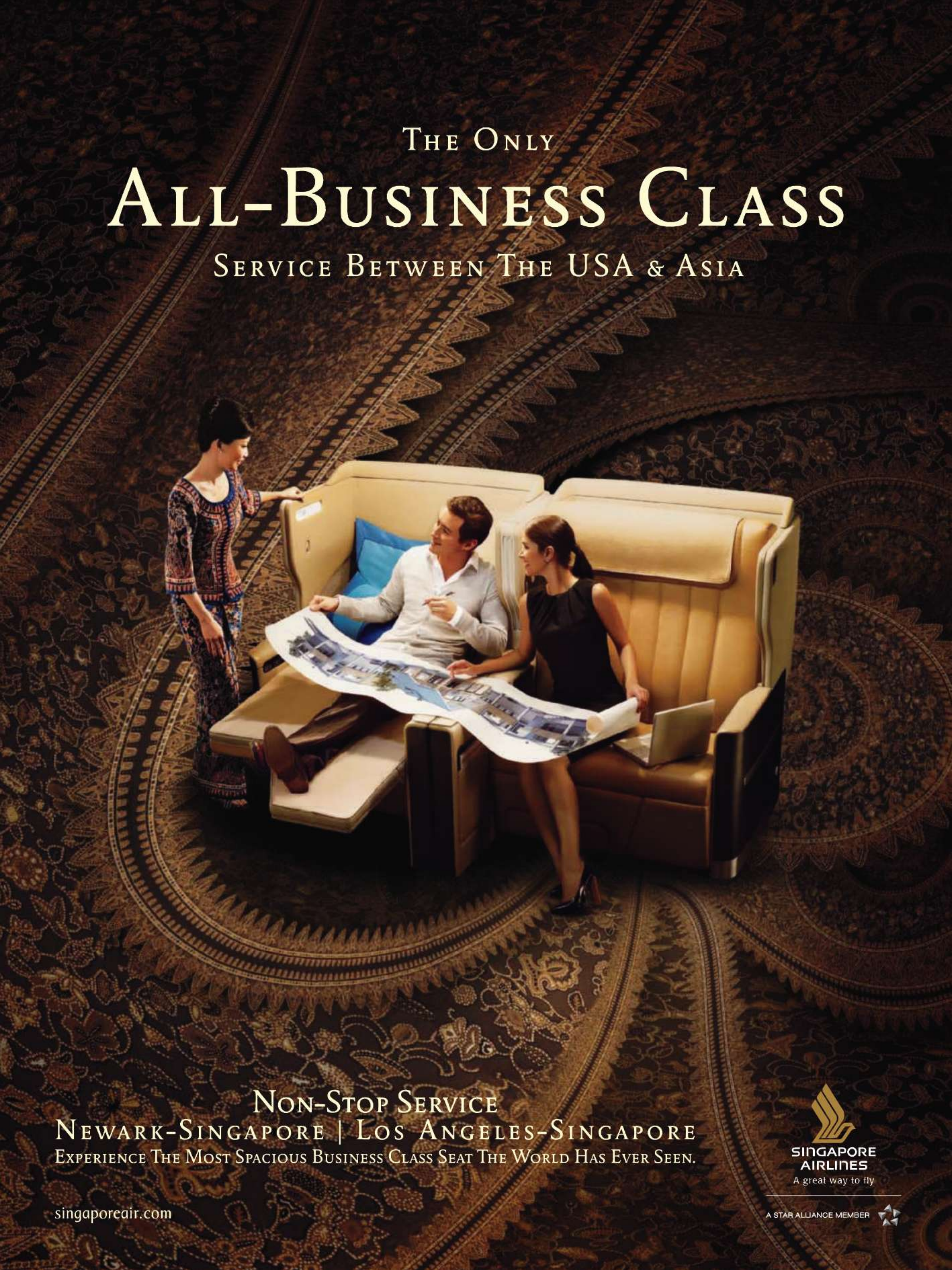
▶ **A new recognition that not all big investors are alike**

▶ **Changes would "at least initially" reduce earnings**

What is a sophisticated investor? According to securities laws, the more money you have, the more knowledgeable you must be, and the better able to look out for your own interests. That's why individuals with a net worth of $1 million or more can make investments that are off-limits to people with less money. Institutions that manage $100 million or more are considered to need the least protection—whether they are small city governments trying to pay for sewers or huge investment companies such as BlackRock. Now, Wall Street's biggest firms are debating whether to change the way they sell opaque financial products like interest-rate swaps to governments, endowments, and not-for-profit institutions, according to executives at four Wall Street firms who spoke on condition of anonymity because their companies haven't made any decisions.

"There is no distinction among very different groups of investors, and this is where things might change," says Dino Kos, managing director at Portales Partners and former head of the Federal Reserve Bank of New York's open market operations. "Wall Street cannot pretend anymore that the treasurer of a small town in the Midwest on a civil service salary and no analytical support has the same level of sophistication as a specialized hedge fund." The changes would "at least initially" reduce earnings because "it would be harder to sell higher-margin products to some customers," says Kos.

The Wall Street soul-searching


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How cities are battling emissions page 49 ▶



was triggered in part by the Securities & Exchange Commission lawsuit against Goldman Sachs for allegedly failing to inform a German state bank and New York-based collateral manager ACA Management about the role of hedge fund Paulson & Co. in a mortgage-linked security. Goldman Sachs executives have said that the firm did everything the law required. Chief Executive Officer Lloyd C. Blankfein was castigated at a U.S. Senate subcommittee hearing in April for selling securities linked to subprime home loans even as the firm's traders were betting against the market. On May 14 the firm said its business standards committee will review practices including "the suitability of products for different types of clients."

While the definition of sophisticated hasn't changed in decades, Wall Street has been selling increasingly complicated products, such as auction-rate securities, collateralized debt obligations, and swaps, which are often used by borrowers with floating-rate debt to lock in rates. Swaps soured for local governments, including those in Jefferson County, Ala., and hill towns in the Umbria region of Italy. JPMorgan Chase, without admitting or denying wrongdoing, agreed to a settlement with the SEC in November that ended an investigation of the bank's derivatives sales to Jefferson County.

Pennsylvania Auditor General Jack Wagner has asked the state's lawmakers to repeal 2003 legislation that allowed school districts and local governments to enter into swaps, which he said was "tantamount to gambling with taxpayer money." In April he said the state's turnpike commission would lose $145.7 million if it had to terminate its swaps contracts on more than $2.2 billion in debt.

Harvard University used $467.6 million from a bond sale in December 2008 to break free from $1.1 billion of interest-rate swaps and separately agreed to pay $425 million over 40 years to reverse $764 million of swaps.

Securities laws differentiate between investment advisers, who have a "fiduciary duty" to their clients, and brokers, who must only determine whether an investment is "suitable." The fiduciary duty obliges advisers to put clients' interests ahead of their own; the suitability standard entails ascertaining whether customers are able to understand and withstand the risks.

The financial reform bill that the Senate passed last month attempts to address sales of swaps. The legislation, which needs to be reconciled with a version passed by the House in December, would require swaps dealers to adopt a fiduciary duty in dealings with state or local governments, endowments, and pension and retirement plans.

Although the measure is designed to protect taxpayers, it has been opposed by state treasurers. In a May 16 letter to Chris Dodd, the Connecticut Democrat who chairs the Senate Banking Committee, the National Association of State Treasurers said that suitability requirements, not fiduciary duty, should apply to dealers.

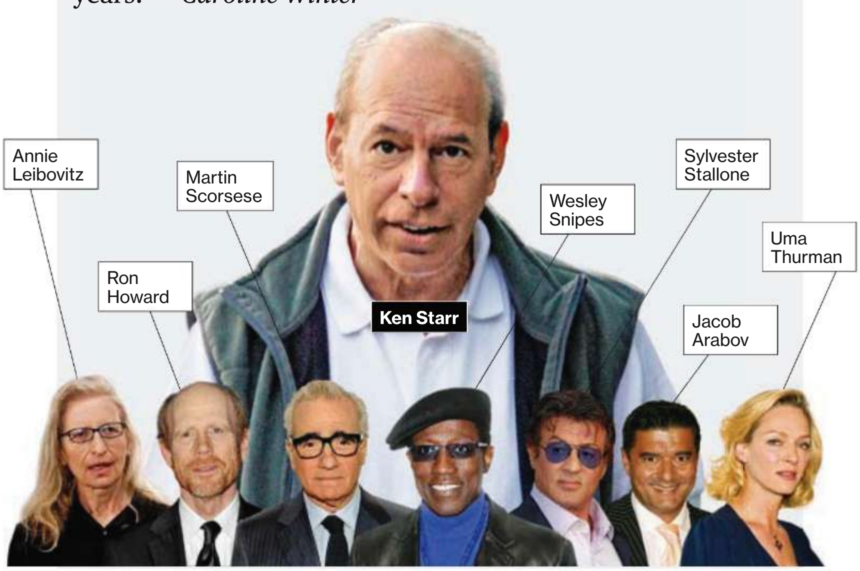
Utah State Treasurer Richard K. Ellis says he avoids using swaps to manage the state's debt because he thinks the risks outweigh the rewards. "We've been pitched on interest-rate swaps as long as I can remember," says Ellis, who served as deputy treasurer for nine years before becoming state treasurer in January 2009. "We've always told them no, and sometimes they've walked away and said, 'You guys are country bumpkins, you just don't get it.' I'm really glad to say I'm a country bumpkin right now."
—*Christine Harper*

The bottom line *Wall Street may cut back on a lucrative practice: selling complex products to big investors who don't necessarily understand them.*

Scandals

Fraud Charges for an Adviser to the Stars

Federal prosecutors have accused financial adviser Kenneth Starr of stealing client money. He has denied wrongdoing. Below, some of the famous folks he has advised over the years. —*Caroline Winter*



DATA: BLOOMBERG, NEW YORK TIMES, WALL STREET JOURNAL

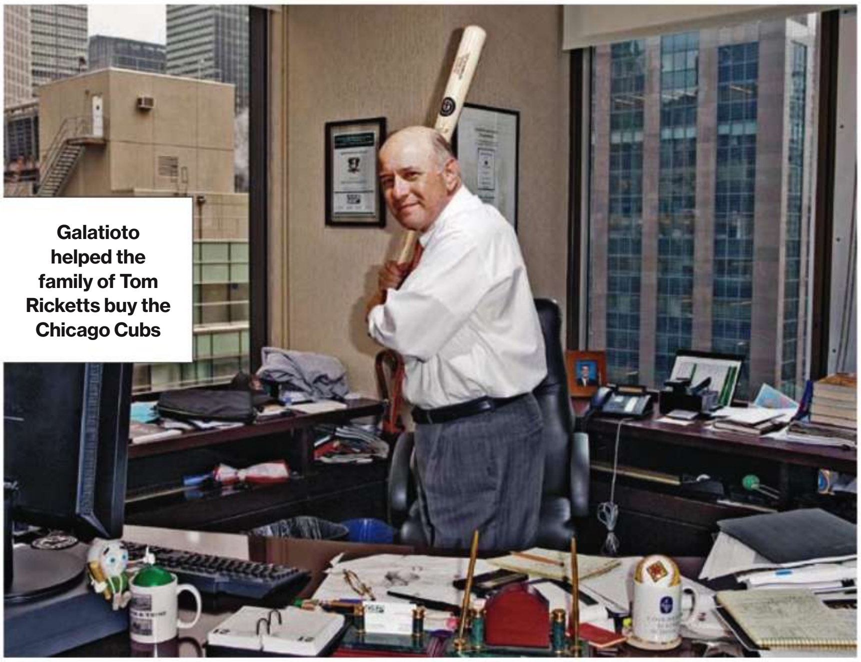
Dealmakers

Sal Galatioto, the Man To See in Sports M&A

▶ His firm has played a role in the sale of numerous big-league teams

▶ He "just kept running through brick wall after brick wall for us"

Last year Sal Galatioto helped the Ricketts family buy the Chicago Cubs for $845 million. This year he helped sell the Charlotte Bobcats of the National Basketball Assn. to Michael Jordan for $275 million. Now Christopher J. Cohan has



Galatioto helped the family of Tom Ricketts buy the Chicago Cubs

hired him to sell the NBA's Golden State Warriors, and he's working on the sale of the National Hockey League's Dallas Stars for Thomas O. Hicks. Over the last decade, while working for Société Générale, then Lehman Brothers, and finally his own firm, Galatioto has helped buy or sell 14 professional sports teams, making him a leader in this corner of the mergers and acquisitions world.

There is no official ranking of sports M&A, but the way Galatioto keeps score, he's in first place. His sports-team transactions accounted for nearly 40 percent of the market's $10.1 billion in deals over the past 10 years, he says. **Goldman Sachs** and **JPMorgan Chase** are also active in the field. "There's only a handful of deals," he says. "If you don't get 30 or 40 percent of those deals and [sports is] the only thing you do, then you're not going to be a viable business." Between transactions, he says, his nine-person Galatioto Sports Partners does "some financing, we do some arena and stadium advising work, we do some expert testimony, we do dispute resolution, whatever we can do to generate income to pay the bills."

Galatioto works out of a Manhattan office crowded with replica stadiums and sports helmets commemorating deals. A photo of Galatioto with New York Yankees owner George M. Steinbrenner hangs near one of a wild hog he shot in Texas in 1999.

Born in Sicily and raised in Brooklyn, Galatioto, 58, got involved in sports when he was in charge of the East Coast region for Société Générale and looking for ways to increase revenue. He built a business lending money to professional teams. Then he asked the bank to let him set up a specialty practice within the bank to focus on sports. "Management there thought I was nuts," he says. "The East Coast region had 30 employees. It was the biggest region the bank had in North America. Now I was going to go out with two guys and do sports."

Despite the bank's doubts, he went ahead. In 1999 he helped Dan Snyder buy the Washington Redskins for $800 million, a record at the time for an NFL team. A few years later he moved the whole practice to Lehman Brothers because he believed the Lehman name would help him land more deals. Five years ago, he left to start his own shop.

Tom Ricketts, chief executive of Chicago's Incapital, retained Galatioto when his family decided to go after the Cubs. "We needed someone who was an expert, who'd been in those trenches a long time," says Ricketts.

On the Cubs deal, Galatioto faced plenty of hurdles. The housing bubble burst. The economy tanked. The Cubs' owner, Tribune Co., entered bankruptcy. Galatioto "just kept running through brick wall after brick wall for us," Ricketts says. "We got to the finish line of a long, tedious negotiation only to find out it would be difficult to get financing. They stepped up, hacked through it, and got us a deal that worked."

Three and a half years ago, Galatioto made a big play for basketball business when he hired Russ Granik, who had retired as the NBA's deputy commissioner. He wooed Granik over Cuban sandwiches on paper napkins. Granik recalls having misgivings: "I said, 'Well, you know, I'm not a banker, and I'm not particularly a salesman.' He said, 'Yeah, but you know sports owners.' " Granik is now vice-chairman, advising clients on league practices and labor issues. The firm's other staffers include several of Galatioto's former students from the sports business class he teaches at Columbia Business School.

Galatioto is considering opening an office in Europe but otherwise doesn't have expansion plans. He credits the firm's small size and personal approach for its success. Sports-team transactions typically involve a few hundred million dollars, and Wall Street firms "aren't going to put the A team on a $250 million deal." —*Aaron Kuriloff*

The bottom line *Concentrating on one small slice of the merger business, Galatioto has made himself a key player in the big-league sports economy.*

Global investing

In China, IPOs Defy the Stock Market Slump

▶ Individuals are snapping up shares, igniting bubble fears

▶ "Investors [believe] that you can't lose money buying new stocks"

China has the world's worst-performing major equity market this year and the best returns on initial public offerings. While the Shanghai Composite Index has fallen by 22 percent as of June 1—for the steepest drop among the 10 largest stock markets—IPOs have surged 29 percent on average during their first month of trading, data compiled by Bloomberg show. That's better than IPOs have fared in any other world market with at least five offerings this year.

The rally by newly listed main-

OPPOSITE: TOP: GREGG SEGAL; STARR: VICTORIA WILL/POLARIS; BOTTOM, FROM LEFT: ACTION PRESS/ZUMA PRESS; GETTY IMAGES (2); WIREIMAGE/GETTY IMAGES; GLOBE PHOTOS/ZUMA PRESS; ZUMA PRESS; LAN/CORBIS. THIS PAGE: PHOTOGRAPH BY ANDREW HETHERINGTON FOR BLOOMBERG BUSINESSWEEK

land companies has made their shares almost twice as expensive relative to profits as the broader market, a sign to some, including **KBC-Goldstate Fund Management** and hedge fund **Platinum Partners**, that a bubble may be forming. "Most of the China IPOs are overvalued," said Larry Wan, Shanghai-based deputy chief investment officer at KBC-Goldstate, which oversees about $583 million. "It's difficult to believe they are going to be able to deliver the sort of exponential growth that the valuations imply."

Chinese companies have raised more than $25 billion through IPOs this year. That number may more than double after the sale of shares by Beijing-based **Agricultural Bank of China**, expected this summer. The nation's third-largest lender by assets will be seeking at least $30 billion in Shanghai and Hong Kong, according to the *Beijing Times*. That would be the world's biggest initial offering, exceeding the $22 billion deal by Industrial & Commercial Bank of China in 2006.

The rally by newly listed companies has been primarily fueled by individual investors, according to Andy Xie, an independent economist in Shanghai.

"Chinese investors have this traditional belief that you can't lose money buying new stocks," said Xie, formerly Morgan Stanley's chief economist for the Asia-Pacific region. "This is not sustainable. China's economy has big bubbles, so does the IPO market. Investors can't be fooled forever."
—Michael Tsang and Inyoung Hwang

The bottom line *Chinese investors are shrugging off the European debt crisis and other concerns, trying to make big scores on companies going public.*

Quoted

"I thought that there would never again be an opportunity to be involved with an industry as socially destructive and morally bankrupt as the subprime mortgage industry. I was wrong. The for-profit education industry has proven equal to the task."
—Steven Eisman, a hedge fund manager who bet against the housing market and is now shorting higher-education stocks.



Personal Investing

More People Are Playing The Options Market



▶ Cheap trades and new technology lure retail investors to derivatives

▶ "Inexperienced ... retail investors will lose money doing this"

David Siniapkin, a postal worker in York, Pa., uses some of the money in his IRA to trade options. Siniapkin, 46, says he tries to profit from strategies such as the "iron condor," which requires placing four different bets on the same security, risking $38 to make as much as $204 on one trade. It takes its name from a diagram, showing how it pays off, that resembles a bird with outstretched wings. After three years and being down as much as $10,000, he says he's broken even.

Siniapkin was one of about 100 people who attended an all-day training class in April provided by online options brokerage **Thinkorswim Group**, which **TD Ameritrade** acquired last year for $749 million. Participants sat in a Radisson hotel ballroom (pictured above) near Philadelphia and scribbled notes as Bob Groves, a former trader at the Chicago Board Options Exchange, waved a laser pointer at a projection screen to explain advanced trades.

Options are contracts that grant buyers the right, without the obligation, to buy or sell a security, a commodity, or an index's cash value at a set price by a specific date. Brokers must approve investors to trade options, says Gary Goldsholle, vice-president in the general counsel's office at Finra, the financial industry's self-regulatory body. Customers must provide details of their finances and trading experience, and sign a document saying they received a copy of "Characteristics and Risks of Standardized Options" from the Options Clearing Corp.

"Trading options is one of the all-time sucker's bets," says Whitney R. Tilson, founder of hedge fund **T2 Partners**. "Most experienced professionals lose money doing it. It's virtually certain that inexperienced, individual retail investors will lose money doing this."

The risks aren't scaring retail investors away. The volume of options trading in the U.S. tripled from 2004, to a record 3.61 billion contracts in 2009. Options trading by individuals in the same period has increased fivefold at **Fidelity Investments**. The number of contracts traded at **Charles Schwab**, another firm that caters to small investors, rose 9 percent in 2009 from 2008.

Retail traders can access professional analytics and trading tools that "weren't even available to institutional investors five years ago," says Andy Nybo, head of derivatives research at Tabb Group. Some brokerages are encouraging options trading by charging commissions as low as 75¢ a contract and providing training sessions. **E*Trade Financial** saw a 600 percent increase in attendance at training events last year, the company says. The cost of the courses ranges from free to thousands of dollars. Thinkorswim's session in April was free; participants were later pitched additional training and online tools, which run from $299 to more than $2,000.

Thinkorswim's founder, Tom Sosnoff, objects to the idea that complex options strategies are too dangerous for individuals. "I'm not a fan of people who say you shouldn't be doing this," he says. "Imagine you walked into the casino and people said to you, 'You look stupid, so you can only play the slots.' "

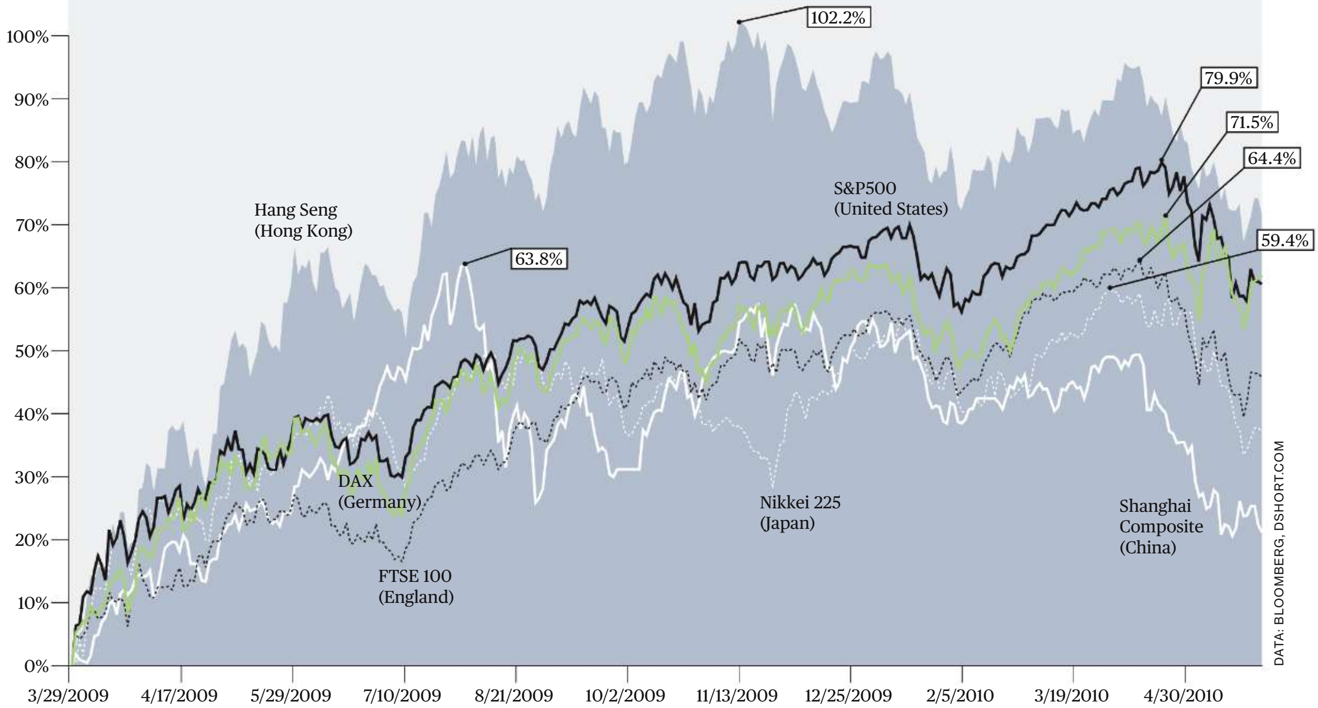
For some investors, the results resemble a trip to the casino. "My first couple of trades I did very, very well, and I got a little bigheaded and very, very greedy," says John Mahoney, 49, an engineer. "I lost about $20,000 initially." Mahoney still trades; he says he made $4,000 one week in April. Karen Fitchett, 64, a real estate investor, says she has lost tens of thousands of dollars trading options since 2007, which is why she still attends classes. "It's become like an intellectual affair," she says. "I just became seduced."
—Margaret Collins and Jeff Kearns

The bottom line *Using options is another way investors try to outsmart the market, and they can also be a quick way to lose money.*

Global markets

It's been a wild ride for stocks around the world

Since Mar. 9, 2009, world stock markets have surged, then swooned. Hong Kong's Hang Seng index had the biggest rise from the low, 102.2 percent, with the S&P 500 second at 79.9 percent. Germany's DAX has fallen the least from its peak, 5.5 percent, as of May 28.



DATA: BLOOMBERG, DSHORT.COM

Finance

A Bittersweet Exit At Deutsche Bank

▶ Michael Cohrs built the mergers business into a global leader

▶ "People are taking us seriously as someone they trust for advice"

Michael Cohrs, co-head of investment banking at **Deutsche Bank**, is retiring just as the bank is becoming a global leader in mergers and acquisitions. So far this year, Deutsche Bank, which long trailed its Wall Street rivals, is now the top takeover adviser in Europe, No. 3 in Asia, and third behind **Goldman Sachs** and **Morgan Stanley** in the U.S., the world's biggest M&A market, according to data compiled by Bloomberg. Globally, the Frankfurt-based bank ranks fourth. "We've been working at this for a decade," says Cohrs, 53, in an interview at the firm's offices in London's financial district. "It's an ongoing buildup, but people are taking us seriously as someone they trust for advice."



Cohrs (below), who joined Deutsche Bank from S.G. Warburg in 1995 and has run investment banking with Anshu Jain since 2004, is planning to retire in coming weeks, according to two people with knowledge of the situation. Jain, head of sales and trading, the bank's biggest moneymaker, is likely to assume his responsibilities, said the sources, who asked not to be named because no announcement has been made. Cohrs declined to discuss his departure.

Deutsche Bank this year gave **Qwest Communications** advice on its $10 billion acquisition by **CenturyTel** and worked with **MetLife** on the insurer's purchase of **American International Group**'s Alico unit for $15.5 billion. It advised **SAP** on its $5.3 billion takeover of **Sybase**.

"Deutsche Bank has certainly joined the bulge bracket in terms of M&A," says Scott Moeller, a professor at Cass Business School in London. "They will have to push hard to maintain their place and ensure the success is not just a flash in the pan."

Even as Deutsche Bank rises in the deal rankings, its M&A fees trail competitors'. The bank generated $210 million in revenue for merger advice as of the end of April, compared with $543 million for Goldman Sachs and $434 million for **JPMorgan Chase**, according to data from Freeman & Co., a New York-based research firm. That

EISMAN: DANIEL ACKER/BLOOMBERG; COHRS: FRANTZESCO KANGARIS/BLOOMBERG

may reflect situations where the bank got credit for working on a deal but had a lesser advisory role, says Jeffrey Nassof, an associate at Freeman.

M&A remains a fraction of Deutsche Bank's revenue, accounting for less than 2 percent of the total $11 billion in the first quarter. "One of the conundrums is that while M&A may not be the biggest or most profitable business," says Cohrs, "it is clearly at the heart and soul of an investment bank because it signals the strength of your relationships."

The financial crisis turned out to be a boon for Deutsche Bank's M&A business. According to Bloomberg, the firm ranked ninth globally in mergers and acquisitions in 2007, a year before the collapses of Bear Stearns and Lehman Brothers ushered in the global credit crunch. As a result of the crisis, clients flocked to financial companies seen as solid. Unlike its largest U.S. competitors, Deutsche Bank didn't have to take a government bailout. It didn't raise capital from shareholders as **Barclays** and **HSBC** did, or get investments from sovereign wealth funds like Swiss rivals **UBS** and **Credit Suisse**. "The crisis for us was quite good in some ways," says Cohrs. "People wanted to feel safe and secure. In the U.S. ... we started to talk to people who hadn't wanted to talk to us."

The crisis helped in another way: M&A heads Brett Olsher, 49, an American, and Norwegian Henrik Aslaksen, 46, accelerated hiring as rivals went under or were acquired. Deutsche Bank has lured 151 new bankers in corporate finance since late 2007.

Cohrs, an American, had originally timed his departure to coincide with the retirement of Chief Executive Officer Josef Ackermann, who was to step down in May. Ackermann agreed last year to stay for another three years because the board couldn't agree on his successor.

For Deutsche Bank, a top priority will be retaining hires, as the sector recovers and competition for talent intensifies. "Deutsche Bank has grown very fast and hired a lot of people from outside," says Ingo Walter, a professor at New York University's Stern School of Business. "If there are lots of external opportunities, there can be a 'why stay?' mentality." Ⓑ

—Jacqueline Simmons and Brett Foley

The bottom line *Cohrs's efforts to build the M&A business got a boost from the credit crisis. Now Deutsche will have to hustle to hold its place.*

Bid & Ask



Art Market

A marathon six-day auction by Christie's in Hong Kong—spanning everything from Chinese antiquities to contemporary works—raised an estimated **$293 million**. Star lots included a 500-year-old Ming-era bronze statue of Buddha, which sold for $9 million—more than double its presale estimate. Other highlights were a group of 10 silkscreens of Mao Zedong by Andy Warhol and a collection of canvases by Chinese-born, Paris-based Zao Wou-ki. Both Christie's and Sotheby's now count Hong Kong as their No. 3 auction center, after London and New York.

Health Care

$2.6bn

Dublin-based Covidien offered **$2.6 billion** for ev3, a U.S. maker of angioplasty balloons, stents, and other products used in heart surgery. Covidien, which was spun off from Tyco International in 2007, is trying to turn itself into more of a pure-play medical-equipment company.

Retailing

Wal-Mart Stores is paying **$1.1 billion** for 193 discount supermarkets in Britain owned by A.P. Moeller-Maersk. Wal-Mart's Asda Group wants to add to its tally of smaller format outlets as it fights to remain the No. 2 food retailer in the U.K.



Finance

Art Samberg, the founder of Pequot Capital Management and a giant in the hedge fund industry, agreed to pay almost **$28 million** to end a six-year probe by the Securities & Exchange Commission. The SEC was investigating allegations that Samberg and Pequot profited from inside information obtained from a Microsoft employee the firm had agreed to hire. Samberg, who announced last year that he was winding down Pequot, will be barred from the investment-advisory business as part of the settlement.

Commodities

$4.7bn

In the year's second-biggest oil-and-gas deal, Royal Dutch Shell is spending **$4.7 billion** to buy most of East Resources of Warrendale, Pa. The transaction will boost Shell's shale-gas acreage. The Anglo-Dutch oil major has been playing catch-up in this category to rivals such as ExxonMobil, which inked a $30 billion shale-gas deal in December.



Finance

CBOE Holdings set a price range for its initial public offering that values the Chicago Board Options Exchange at about **$2.9 billion.** The CBOE, the last major market in the U.S. controlled by its members, aims to raise $339 million from the share sale.



Collectibles

A one-of-a-kind baseball rookie card featuring 21-year-old pitching phenomenon Stephen Strasburg of the Washington Nationals sold for **$16,403** in an eBay auction.

Entertainment

An investor group headed by Simon Fuller, the creator of the *Idol* TV series franchise, has submitted a $600 million offer for CKX, the entertainment company that owns the rights to *American Idol*, as well as those to Elvis Presley's name and image. *American Idol*, which just wrapped up its ninth season (winner Lee DeWyze, below) remains the most-watched prime-time TV program, though its viewership has been declining over the years.



CLOCKWISE FROM TOP: CHRISTIE'S/BLOOMBERG; COURTESY TOPPS; TED SOQUI/CORBIS; SCOTT OLSON/GETTY IMAGES; JOHN MARHALL MANTEL/THE NEW YORK TIMES/REDUX

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Contents ▶ Companies count their carbon 50 ▶ Biofuels from almost anything 52 ▶ Filling up at 220 volts 52 ▶ Meet the climate consultants 53 ▶ Commerce Secretary Locke on green energy in China 54 ▶ A British utility bets big on biomass 56 ● Edited by David Rocks



Biking in L.A.: Dedicated lanes and even showers and changing rooms

The Greening Of the Metropolis

▶ Cities take the lead in the global fight against carbon emissions

▶ "We're not going to wait for national politicians," says Toronto's mayor

Los Angeles: city of freeways, smog, and...bike lanes? That's where Mayor Antonio Villaraigosa wants to take his town. In one of the less likely transformations in the global effort to cut carbon dioxide emissions, Los Angeles plans to spend $230 million on 1,700 miles of bicycle paths. Most of the program will be completed by 2015 and includes changing rooms, showers, and bike storage areas operated by the city and private partners. It comes on top of subsidies for installing solar panels and incentives for planting trees and switching to electric vehicles. "We have to make a change," says Michelle Mowery, senior coordinator for the bike program. "We can't fit any more cars in."

From the freeways of Los Angeles to the canals of Amsterdam, cities are taking the lead in the fight to reduce carbon output. As world leaders squabble over how to cut greenhouse gases, city hall is becoming the best hope for climate action. Given their smaller jurisdictions, local officials can green-light eco-projects faster than nationwide schemes can be implemented. "We're not going to wait for national politicians, we're acting right now," says Toronto Mayor David Miller, who plans to invest more than $1 billion in public transport and eco-friendly air-conditioning systems for buildings by 2017.

Cities are home to more than half the world's population and pump out more than two-thirds of global CO_2

The efforts could have a profound impact: Cities are home to more than half the world's population and pump out more than two-thirds of global carbon dioxide. That share will surely grow as people flock to megacities in the developing world. "It's obvious where the fight for a sustainable civilization will be decided, and that's in large cities," says Peter Loescher, chief executive officer of **Siemens**, which aims to profit from selling its streetcars, wind turbines, and other technologies to municipalities worldwide.

Just as no two cities are alike, there are vast differences in local

PHOTOGRAPH BY GREGG SEGAL FOR BLOOMBERG BUSINESSWEEK

strategies. In Toyko 68 percent of trips are already made by bike, subway, or on foot. Houston residents, by contrast, make 95 percent of their journeys by car. So while the Texas city is giving officials electric vehicles to reduce emissions, the Japanese capital in April announced a citywide CO_2 cap-and-trade program—the kind the U.S. Senate has been unable to pass so far. Copenhagen will spend $1.6 billion by 2012 on bike paths, green energy projects, and retrofitting city buildings. Melbourne plans to bar cars from downtown and offer incentives to developers who invest in efficiency. "It's a green gold rush," says Robert Doyle, Melbourne's Lord Mayor.

In Amsterdam, city elders are in the midst of a five-year, $1 billion program to improve creaking infrastructure. Amsterdam's 2,400 houseboats have been fitted to use electricity instead of diesel, and cargo barges are now being converted as well. Some 300 homes are testing display panels that show energy usage in real time, a program that may be expanded citywide. If residents can be persuaded to use the technology to cut power use at peak times, their electricity bills could fall by up to 40 percent, says Ger Baron, who oversees the project. "Our biggest challenge is changing people's habits," he says.

New York, meanwhile, has laid out a program called "PlaNYC." The scheme includes tax breaks for solar panels, legal changes that spur property owners to make buildings more energy-efficient, and power plants that use food waste and wood chips. Though a proposal to charge a congestion fee for drivers entering much of Manhattan couldn't pass the state legislature, the Big Apple hopes to quadruple its 450 miles of bicycle paths by 2030. New York's plan has even sparked envy on the West Coast. "Los Angeles isn't New York," says L.A. cycling chief Mowery. "But we're getting there."
—*Mark Scott and Jeremy van Loon, with Stuart Biggs*

1,700

Miles of bike paths planned for Los Angeles

The bottom line *As national governments fail to cut carbon, cities are starting to take the initiative with programs aimed at reining in emissions.*

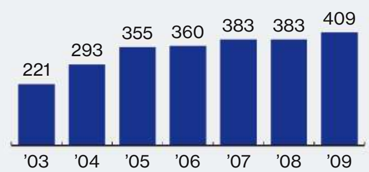
Greenhouse Gas Emissions

How to Go on A Carbon Diet

▶ Corporations are starting to add up their carbon output

▶ Green Disclosure:

Number of the world's 500 biggest companies reporting on climate change to the Carbon Disclosure Project



DATA: CARBON DISCLOSURE PROJECT

Workers at **Toyota Motor**'s 20,000-sq.-ft. data center in California may have been puzzled by the strange metal cart being pulled through the aisles over the past year. The high-tech trolley was developed by **IBM** to sniff out wasted energy using heat-seeking sensors that collect a floor-to-ceiling, three-dimensional view of a room in cool blues and hot reds. It sees "in color exactly where the heat is coming from so you can address it," says Wayne Balta, vice-president for corporate environmental affairs at IBM. The machine has helped IBM trim its own energy use by 5.4 percent and has saved nearly 350,000 tons of carbon dioxide emissions for clients, he says.

Cutting carbon is becoming de rigueur for multinationals. More than 80 percent of the world's 500 biggest companies now report their greenhouse gas emissions and climate change strategies to the London-based Carbon Disclosure Project, which compiles the information for investors. Measuring carbon emissions "is part of managing a responsible business in the 21st century," says Adam Kanzer, managing director of Domini Social Investments, which manages about $1 billion in assets.

Some of the savings are easy. IBM's data centers, for instance, are energy-intensive, and the company found substantial savings via simple measures such as installing fans near hot spots. And Toyota's efficiency gains came mainly from removing two air conditioners from the data centers.

It can be hard to tell how deep such efforts really go: Are they a sincere attempt to reengineer processes or just greenwashing? Oil giant **BP**, despite its "Beyond Petroleum" slogan, invests $12 billion annually in oil and gas research—25 times what it spends on wind and solar. And even when companies do count carbon, they often focus more on the opportunities than on the risks. In an **Ernst & Young** survey of 300 companies in 16 countries, 85 percent said new revenue opportunities were a big part of climate-change initiatives. Corporate green commitments can be "very murky," says Gwen Ruta, vice-president for corporate sponsorships at the Environmental Defense Fund. "You really have to dig to try to understand what the company is actually saying."

Many companies, though, are getting more serious about the carbon threat. **Wal-Mart Stores** this year began a program to prod its 100,000-plus suppliers to cut greenhouse gas emissions by 20 million metric tons over five years. That includes buying more products locally, reducing packaging, and finding the most energy-efficient products. In April wind turbines were put atop parking lot light poles at two Wal-Mart outlets to supply some of the stores' electricity.

Office Depot is aiming to cut carbon by trimming deliveries. The company made about 25 million customer deliveries in 2008, generating 53,000 tons of carbon dioxide, says Yalmaz Siddiqui, the company's director for environmental strategy. In April, Office Depot began offering rebates that encourage customers to consolidate orders, which reduces fuel use and emissions. "None of it matters in and of itself, but it all matters in the aggregate," Siddiqui says.

Quoted

"The spill in the Gulf, which is just heartbreaking, only underscores the necessity of seeking alternative fuel sources.... with the increased risks, the increased costs... we're not going to be able to sustain this kind of fossil fuel use. This planet can't sustain it."
—*Barack Obama*



U.S. COAST GUARD/GETTY IMAGES


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Duke Energy's Rogers and the climate war page 58 ▶

Biofuels

Hey, It's Fuel—Don't Worry About Where It Comes From

As researchers worldwide scramble to find alternatives to oil, they're beginning to make use of some pretty unusual raw materials. Talk about natural resources–it turns out that just about any kind of plant or animal waste, and many kinds of garbage, can be turned into biofuels or other sources of clean energy for cars, trucks, or industry. Here are some of the least expected possibilities being tested. —*Esmé E. Deprez*



CHOCOLATE

Researchers at Britain's University of Warwick have built a Formula 3 race car that runs on 30 percent biodiesel derived from chocolate waste. As a bonus, the steering wheel is partially made of carrots and other root vegetables.



DIRTY DIAPERS

A plant in Quebec turns soiled diapers into fuel. Using a method called pyrolysis, the plant heats up the diapers without oxygen. That breaks down the molecules of both the diapers and their, um, contents, yielding synthetic methane gas and diesel-like oil.



TURKEYS

Bones, beaks, and feathers: A Carthage (Mo.) refinery can make diesel that's 80 percent turkey parts from a nearby slaughterhouse. The plant, which went bankrupt and closed last year, is slated to reopen with a capacity of 12 million gallons a year, double its original size.



HUMAN FAT

Beverly Hills plastic surgeon C. Alan Bittner didn't want the fat from his liposuction patients to go to waste, so he turned it into "lipodiesel" to power his car, California health officials say. Authorities believe Bittner stopped making the fuel after the state launched a probe.



URINE

Ohio University's Gerardine Botte can convert urine to hydrogen, which is used to make electricity. While it's hard to collect enough human urine to make the process commercially viable, it may be a boon for hog farmers, who have trouble disposing of pig urine.



BEEF BY-PRODUCTS

Amtrak carries human passengers on the backs–and other parts–of cattle. The Heartland Flyer rides the rails between Oklahoma City and Fort Worth using a biodiesel blend known as B20: 20 percent fuel made with beef by-products and 80 percent diesel.



COFFEE

Coffee grounds can consist of up to 20 percent oil, making them an abundant source of biofuel. Researchers at the University of Nevada-Reno have separated oil from grounds and turned it into biofuel. The result even smells like your favorite java joint.



COW MANURE

Every cow creates enough waste to keep two 100-watt light bulbs lit 24 hours a day, according to utility Central Vermont Public Services, which has offered "Cow Power" since 2004. Manure from 5,000 cows is used to make methane, which fires generators.

Bon Appétit Management, which provides food services for more than 400 corporations and colleges, is cutting its carbon footprint by making menu changes such as substituting turkey burgers for higher carbon beef burgers; a pound of beef generates the equivalent of 21 pounds of CO_2 as cattle emit methane through their digestive system, says Maisie Greenawalt, Bon Appétit's vice-president for culinary development. The company has reduced its use of beef by 33 percent since 2007. "We see our sustainability commitment," Greenawalt says, "as being overall cost-neutral." —*Christopher Martin, Jim Efstathiou Jr., and Esmé E. Deprez*

The bottom line *Counting carbon is getting more common at corporations, though it's not always easy to tell how effective their strategies are.*

Electric Cars

A New Meaning for the Phrase "Charge It"

▶ **Companies rush to build the filling stations of the 21st century**

▶ **"Two chargers are needed for each car"—one at home and one at work**

Anton Klima is a self-described electric car fanatic. The Los Angeles television cameraman is already on his second electric vehicle, a battery-powered BMW Mini E. To make sure he's carbon-free, he charges the car from solar panels on the roof of his Hollywood Hills home. But when he's out and about, Klima has to make do with a patchy network of public chargers left over from California's original electric-car campaign a decade ago. Though he can now track down chargers with an iPhone app, the shape of the plugs has changed, so Klima has to carry three adapters to be sure he can power up. "After a while you get used to [the hassles]," Klima says.

U.S. policymakers can't count on that kind of dedication as they map out the electric-car future. President Barack Obama aims to get a million electric cars and plug-in hybrids on U.S. roads by 2015 to ease U.S. reliance on imported oil and cut carbon emissions. The first two mass-market electrics, **Nissan**'s Leaf and the Chevy Volt, are set to hit the streets this fall.

FROM TOP: JASON E. MICZEK/AP PHOTO; CHART ICONS BY MATT OWENS

The problem will be finding places to charge all those vehicles. To eliminate "range anxiety"–EV-speak for the fear of being stranded with drained batteries–drivers will need to know they can plug in at shopping centers, restaurants, or parking meters. "Two chargers are needed for each car–one where you live and one where you work," says Richard Lowenthal, chief executive officer of **Coulomb Technologies**, a California-based maker of electric car charging stations. Building that infrastructure, he estimates, "may be a $12 billion industry."

Recognizing the need for charging stations (like the one below in Arlington, Va.), Democratic and Republican House and Senate members on May 27 proposed legislation to expand tax credits for the installation of charging equipment as well as electric vehicle purchases. The measure would direct the Energy Dept. to award $800 million in grants to support charging facilities for 700,000 electric vehicles within six years.

Coulomb is one of at least a half-dozen companies aiming to win some of that cash and build the fuel stations of the 21st century. Lowenthal plans to install 4,600 chargers in nine U.S. metropolitan areas by the end of 2011 at a cost of $2,000-$5,000 each. The company also aims to offer smartphone apps and navigation software that will guide drivers to the nearest available charger.

Arizona-based **ECOtality** has won a $100 million federal grant and is working with Nissan to install more than 11,000 chargers in five U.S. states within three years. Nissan is also working with a company called **AeroVironment** to put charging equipment in homes, and it hopes to build a network of public chargers as well.



L.A. drivers need to carry at least three adapters for various plugs

Better Place, based in Palo Alto, Calif., is taking a different approach: Instead of simply charging cars, the company plans to open stations where drained batteries can be swapped for charged ones. The startup expects to introduce its service next year in Israel and Denmark; Hawaii and the San Francisco Bay Area will likely be its first U.S. markets.

SemaConnect, based in Annapolis, Md., has developed a $2,500 wall-mounted charger for public use. The company has sold the devices to three locations in the Washington area. At one, a hotel in Annapolis, Md., Russell Rankin charges a fleet of 10 electric cars that he uses to shuttle guests to local attractions. Rankin says he plans to order more chargers as his company grows. "Our expansion plans are facilitated by these chargers," he says.

Utilities are preparing for the shift as well. While they say they should be able to handle the extra load, upgrades are needed. These include transformers to keep neighborhood circuits from overloading if multiple cars are plugged in at once, smart meters to monitor how vehicles charge, and rewiring older homes to handle 220-volt charging devices, says Pedro Pizarro, an executive vice-president at **Southern California Edison**, California's largest utility. "We need to know when people are charging, what vehicles they're charging," he says.

Some experts caution against moving too fast. Mark Duvall, director of electric transportation for the Electric Power Research Institute, an industry group, believes it may be hard for the U.S. to reach Obama's target. He predicts sales are unlikely to top 15,000 electric cars annually before 2013. "If you build some solid gold-plated infrastructure before you understand what the public wants or needs," he says, "you're going to squander a lot of resources."—*Alan Ohnsman, with Saritha Rai*

The bottom line *As companies compete to provide charging services, a dominant approach and technical standard have yet to emerge.*



FROM TOP: DANIEL ACKER/BLOOMBERG/GETTY IMAGES; KRISTOFFER TRIPPLAAR/SIPA PRESS

Regulation

The Rise of the Climate Consultant

- ▶ As the SEC asks for climate risk disclosure, an industry blooms
- ▶ "I'm humbled by how little I know" about climatology

Dan Rice thought he knew more than most investors about weather and climate risk. As a managing director of **BlackRock**'s $1-billion Energy & Resources Fund, he uses weather forecasts to gauge heating demand that moves the oil and coal markets. In 2009, as climate change became a more pressing issue for U.S. businesses, he grew concerned about the coal companies in his portfolio; he wondered if climatologists knew something he didn't. Rice commissioned **Atmospheric & Environmental Research** (AER), a Lexington (Mass.) consultancy in to synthesize the climate literature. After he sat down to read AER's 35-page report, he says, "I was humbled by how little I know–and how much uncertainty there is in the existing science."

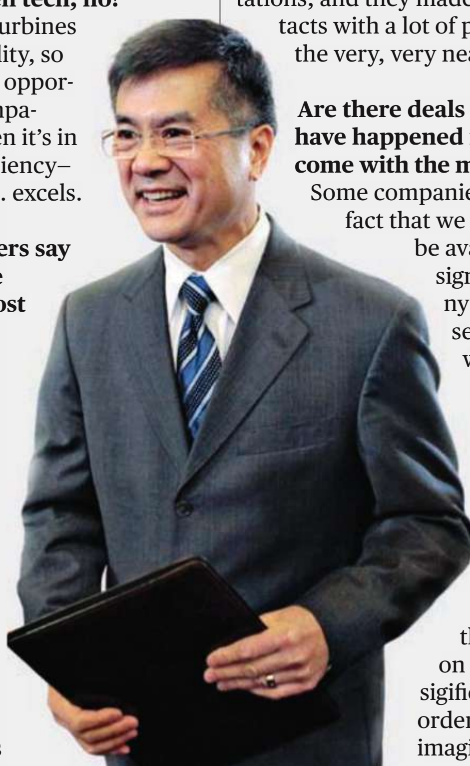
Speed Dial

Obama's Energy Salesman

Promoting green-tech exports on a trade mission to China, U.S. Commerce Secretary Gary Locke spoke with reporter Mark Drajem

Isn't trying to sell green technology to China like bringing coals to Newcastle?
No, because the Chinese can't do it all. A lot of their technology isn't as advanced as the United States', and it's going to be much more expensive for them to not go with the very best technology and therefore have to revamp or buy again in a few years.

China has really ramped up production of green tech, no?
Not all of the wind turbines are of the same quality, so there are incredible opportunities for U.S. companies. Especially when it's in areas of energy efficiency–that's where the U.S. excels.



Many U.S. lawmakers say imports of Chinese solar panels will cost American jobs. Do you agree?
That's why the U.S. has to have an energy policy. Companies aren't going to put their time and capital and R&D into Technology A if ultimately U.S. energy policy is going to favor Technology B. At the same time, the Germans, the Chinese, and the Danes are rushing ahead. If we don't watch out, we're going to wake up three or four years from now and say, "How is it that Shanghai is the Silicon Valley of clean energy, with all the jobs?"

One concern is that as the Chinese rush ahead, they may not be rushing in the right direction.
There is obviously the challenge of trying to move all the electricity generated in various parts of the country to the areas that need it. That's why they are trying to ramp up a smart grid. That's where our companies can help them maximize efficiency.

What were the most tangible successes of this trade mission?
A lot of companies were able to increase sales beyond their initial expectations, and they made incredible contacts with a lot of potential deals in the very, very near future.

Are there deals that wouldn't have happened if you hadn't come with the mission?
Some companies said that the fact that we were going to be available for the signing ceremony got the deal sealed. And some were able to increase their sales. We may even have announcements of those increased deals in the coming weeks. Several reported that they were on the cusp of sigificantly bigger orders than they ever imagined. Ⓑ

Rice belongs to a growing pool of market players who are boning up on their climatology. Although the fate of climate legislation in the Senate is uncertain at best, some companies are snapping to attention because of a mix of federal action and historic weather calamities–the kind scientists say are likelier in a warmer world. Flooding in early May killed 30 people in the Southeast. The East Coast braved two "once-in-a-century" snowstorms in two months. This decade is the hottest in recorded history. Despite intense opposition, the Environmental Protection Agency is moving ahead with carbon regulations. And in February, the Securities & Exchange Commission urged public companies to disclose material risks from climate change. Pension funds, state treasurers, and nongovernmental organizations asked the SEC to act because, they said, climate risk is changing business. The SEC's "interpretive guidance" creates no new regulations; instead, it suggests how existing rules might apply to climate.

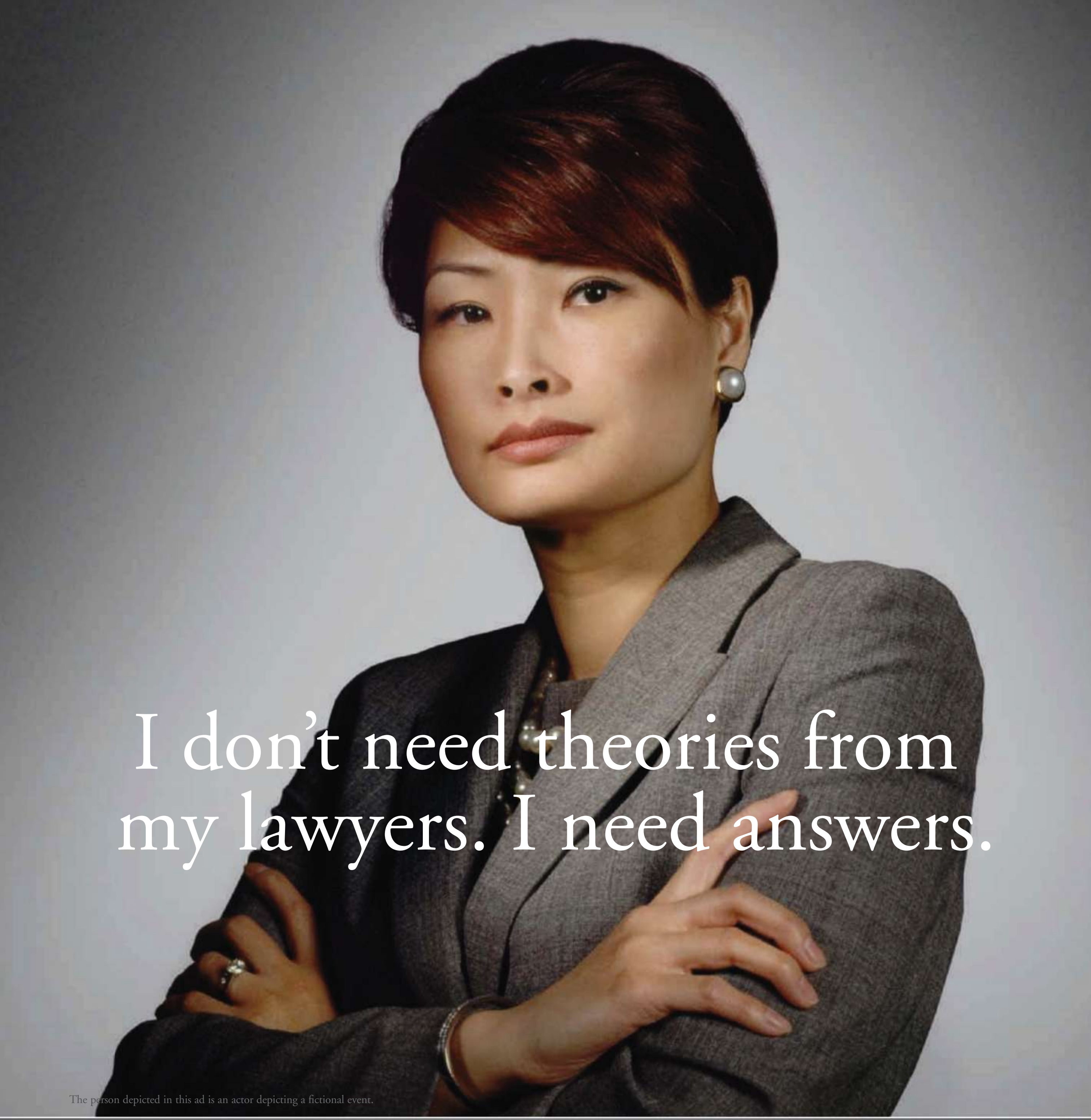
$4.1

Estimated size, in billions, of the U.S. climate-consulting market

Demand for expertise is growing. On May 25, Ernst & Young released a survey of 300 companies, 70 percent of whom expect to boost outlays on climate-related initiatives in the next two years. British research firm Verdantix puts the U.S. climate consulting market at $4.1 billion, rising to $5.7 billion by 2014. Five years ago this business was a blip, says Greg Holland, a senior scientist at the National Center for Atmospheric Research, which advises insurers and offshore energy firms, including **Chevron** and **Royal Dutch Shell**. Today companies such as AER–a unit of insurance information company **ISO**–have climatologists and risk experts on staff.

Next to the oil spill, the SEC's move will turn out "to be the biggest event in the next 12 to 18 months," says Jeffrey A. Smith, who runs the environmental practice of Cravath, Swaine, & Moore. Disclosure, he says, isn't just measuring a carbon footprint. It means rethinking strategy–and confronting fuzzy 21st century risks. The

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oil spill and climate are related in this sense: Business doesn't account well for rare events. The Gulf disaster is a so-called black swan, an unlikely catastrophe of incalculable cost–which is a good analog for climate predictions.

Rice and his peers make a living by betting on known risks and rewards. Rare events don't make it into the equation. Rice says a fund that hedged a decade ago against the possibility of an offshore blowout wouldn't have had oil stocks–or customers. "You'd be correct, but it doesn't do you any good," he says.

Rice didn't sell coal stocks after reading AER's report–"not because we love coal, but we love coal stocks because they appear to be overly discounting the negative headlines." He can't bet other people's money today on weather events in the 2030s. As SEC disclosures say, past performance is no guarantee of future results. The same might be said for the earth's operations.—*Eric Roston*

***The bottom line** Assessing climate risk is difficult, but a $4 billion consulting industry is emerging to meet a growing need for expertise.*

Power Generation

Is Elephant Grass The New Black?

▶ Why Drax Group is retooling its coal plants to burn biomass

▶ Without guaranteed support, the technology is "just too risky"



The power station outside the village of Drax, 150 miles north of London, keeps some 3 million tons of coal in vast black heaps to the west of the plant. But when visitors show up these days, officials at the **Drax Group**, which owns the facility (above), are more interested in showing off the fuel on the north side: thousands of bales of elephant grass stacked 30 feet high. While the 3,900-megawatt plant produces some 7 percent of Britain's electricity and is the country's single biggest carbon polluter, Drax Chief Executive Officer Dorothy Thompson envisions a much greener future. "We've become more and more concerned about carbon," she says.

Thompson's plan is to shift away from coal and start burning more grass, tree bark, and similar fuels, known as biomass. After an expansion completed this year, the station can use such fuels for as much as 12.5 percent of its output, making it the world's biggest biomass plant. On a life-cycle basis, biomass emits about one-tenth the greenhouse gas that coal does; burning the plant matter also means it won't decompose and release methane, a greenhouse gas far more potent than carbon dioxide. By 2014, Thompson wants biomass to make up half of Drax's fuel.

The plant lies at the heart of England's "Megawatt Valley," a chain of four coal-fired plants built in the 1960s and '70s alongside a massive Yorkshire coal field. About one-third of British power comes from coal plants, many of which are slated to be shut down over the coming decade. Replacing the country's coal power with nuclear, gas, and wind could cost nearly $300 billion, according to Britain's energy regulator. "You can see why [biomass] is where Drax wants to go," says Anthony White, founder of green energy investor Climate Change Capital. "If you don't come up with some way of reducing emissions, you don't have Drax in the long term."

Elephant grass today costs about triple what coal does

By 2013, Drax aims to build the first of three 290-megawatt stations that burn wood, straw, and grass. Those power plants would cost nearly $1 billion each and burn a total of 1.4 million tons of biomass per year. Thompson hopes to make a final decision on the new plants by December, depending on how much support the government is willing to offer. Elephant grass and other biomass fuels today cost three times what coal does, so biomass-fueled turbines need subsidies to be profitable.



Although the U.K. government is willing to fund biomass, the support can be as little as 25 percent of what wind-power producers get. Worse, there's no certainty of long-term backing for biomass, while wind plants get a 20-year guarantee of payments at today's levels. "You can't build a new plant today and know what your support is going to be," Thompson says. "That's just too risky."

She may have little choice. If Drax fails to diversify away from coal, by 2013 the company would have to spend some $850 million annually on carbon permits under European Union regulations, Bloomberg New Energy Finance estimates. That's more than double what analysts expect Drax to earn this year. Thompson's biomass initiative is evidence that she recognizes Drax needs to change, but she's quick to say that the coal era is far from over. "The U.K. is going to need [coal] for some time," Thompson says, looking out over the plant. Even without biomass, "we don't feel Drax is on a path to shut down tomorrow." Ⓑ —*Kari Lundgren and Catherine Airlie*

***The bottom line** Facing potentially crippling carbon emission payments, Drax is shifting to biomass fuels.*

FROM TOP: ROY RAINFORD/GETTY IMAGES; MARK FAIRHURST/UPPA/ZUMA PRESS


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The Yoshida children have a lot of energy. But the country they're growing up in doesn't. Japan needs affordable, reliable energy. Shell is helping to deliver this energy in the form of liquefied natural gas. Not just for tonight's warming noodles, but potentially in years to come, when they may have children of their own. It's another example of how we're helping to build a better energy future. Let's go.
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The Smooth-Talking King Of Coal —And Climate Change

In a May 26 speech, President Obama promised that the worst oil spill in U.S. history won't keep him from "fighting to pass comprehensive energy and climate legislation"—including a cap on carbon emissions. The cap faces ferocious opposition in Congress from oil- and coal-state politicians, Democrats and Republicans alike, who fear it will drive electricity rates to unsupportable levels and send jobs overseas. This adaptation from *The Climate War,* the new book by *Bloomberg Businessweek* Deputy Editor Eric Pooley, tells the story of one power company boss, Duke Energy CEO James E. Rogers, who is navigating these difficult choices for his shareholders, his customers, and, he says, his grandchildren.



ILLUSTRATION BY JAMES DAWE


irty
Duke
Energy
Let's go backwards!
Duke
Energy
PRO
-TEST
BUILD

When Jim Rogers introduces himself to an audience—something the president, chairman, and chief executive of Duke Energy does many times a month in speeches and panels around the country—he likes to start by explaining how much pollution it takes to generate power for 12 million people in five states. "We're the third-largest emitter of CO_2 among corporations in America because we generate 70 percent of our electricity at 20 coal-fired plants," he says. "Of all the companies in the world, we're the 12th-largest emitter of CO_2. I share these numbers with you not to brag, but to give you a sense of my special responsibility, the daunting job in front of me. And for you to understand why I have such passion about confronting the climate issue."

Rogers says these things in a disarming Kentucky drawl that quavers slightly, like any good preacher's, as his sermon takes flight. He can talk the down off a duckling, but environmental activists—especially in Charlotte, N.C., where Duke Energy is based—dismiss him as a fraud, a greenwasher, a silver-tongued huckster with world-class PR. As proof, they point to a place 50 miles west of Charlotte, called Cliffside, where Duke Energy is building a new 825-megawatt coal-fired power plant that has no chance to capture or store any of the carbon dioxide it will be sending forth over the next 40 or 50 years. Rogers calls it "the last coal-fired plant I will ever build." But for those acquainted with climate science, which has concluded that emissions reductions are necessary to avoid potentially catastrophic global warming, that isn't good enough. So activists picket Rogers' annual meetings, chain themselves to Cliffside's bulldozers, and fall to their knees at conferences where he appears, begging him not to build the plant and asking how he sleeps at night.

"How I sleep at night," he tells them, "is Lunesta."

Coal-fired power plants like Duke's generate cheap, plentiful electricity. One reason they're cheap is that they spew their CO_2 for free. When the industry finally starts to capture and store that CO_2 in underground aquifers, in a process known as carbon capture and sequestration (CCS), coal-fired power won't be so cheap anymore. That's why keeping the lights on and the power affordable while cutting emissions is what Rogers calls "the greatest judgment of what I do. I have seven grandchildren. They will judge me someday. When they are my age they will look back and say, 'My granddaddy, he had this ecological crisis.... What did he do?'"

What he did, beginning in 2006, was to join nine other Fortune 500 chief executives and the leaders of four national environmental groups to create a lobbying coalition intended to break the American business community's de facto veto power over climate legislation. The U.S. Climate Action Partnership (USCAP), as the coalition called itself, got its start early that year when two green leaders, Fred Krupp of the Environmental Defense Fund and Jonathan Lash of the World Resources Institute, recruited Jeffrey R. Immelt. The General Electric chief helped bring in the CEOs of nine other corporations (membership later grew to 25), including Alcoa, DuPont, Caterpillar, and BP America. The companies had compelling business reasons for backing carbon regulation. GE, the biggest wind turbine maker in the U.S., was developing carbon-capture technology. A single wind turbine included 14 products made by DuPont. That made their participation logical—and diluted its impact. The coalition needed someone with plenty at stake, someone whose company spewed huge amounts of CO_2. They needed a high-emitting, smooth-talking, coal-fired power boss willing to buck his own industry. They needed Jim Rogers.

A Trial Run

In the late 1980s, as the newly minted CEO of PSI Energy—a small, beleaguered Indiana utility that, through of series of mergers and acquisitions, eventually became part of Duke Energy—Rogers got on the wrong side of some of his fellow utility bosses by supporting a mandatory declining cap on the sulfur dioxide pollution that causes acid rain.

His industry was almost universally opposed to this so-called cap-and-trade program, but Rogers saw a way to make money: The free allowances and rate increases that would come with the program gave his cash-strapped utility a capital injection. Rogers, who got his start as an energy lawyer at Akin Gump Strauss Hauer & Feld, also remembered a piece of advice that his former boss, the political fixer Robert Strauss, had given him: "When you see a parade form on an issue in Washington, you have two choices: You can throw your body in front of it and let them walk over you, or you can jump in front of the parade and pretend it's yours."

Up at the head of the acid rain parade Rogers met another young, energetic CEO: Fred Krupp of the Environmental Defense Fund (EDF), the centrist group that helped design the acid rain cap-and-trade program and push it through Congress in 1990. They didn't get to know each other well, but Rogers appreciated that Krupp didn't treat him like a villain. Krupp appreciated that Rogers was just about the only coal-fired utility boss to testify on behalf of the program.

The cap-and-trade program proved enormously successful—cutting acid rain pollution ahead of schedule for a fraction of the projected cost—but utility bosses are a blunt group with little tolerance for flamboyance. Rogers was cast as a slippery self-promoter. "He was talkative and very public, and they resented him for it," says Entergy CEO J. Wayne Leonard, who worked for Rogers for 10 years. "They called him the Elmer Gantry of the electric industry, but Jim had a lot more conviction than people gave him credit for."

By 2008, as the Lieberman-Warner Climate Security Act became the first global warming bill to move through committee to the Senate floor, Rogers was at it again, this time with carbon. Some of his peers thought global warming was an Al Gore hoax, and here was Rogers playing the visionary at climate conferences, drawing up plans to decarbonize Duke Energy by 2050 and spouting other radical ideas that could disrupt the industry and put whole companies out of business—maybe even Duke, if he wasn't careful. Rogers saw something most of his counterparts did not. "I've never had a polar bear moment," he says. Rather, he had come to view the climate problem as a business opportunity, just as acid rain had been. "I made money on sulfur," he would tell people, "and I'll make money on carbon."

Rogers wasn't sure whether he was going to be able to support the Lieberman-Warner climate bill, which would have put the U.S. economy on a carbon diet, cutting CO_2 emissions by about 50 percent by 2050. He wanted to support the bill, but the numbers had to work for Duke: Congress had to give his company enough free carbon allowances—permits granting Duke the right to emit CO_2—to make the transition to clean electricity

OPENING SPREAD: ROGERS: CHRIS KEANE/NYTIMES/REDUX; OPPOSITE PAGE: MANUEL BALCE CENETA/AP PHOTO

affordable for his customers. He was the first to admit that he didn't know how it was all going to turn out. "I'm a work in progress, O.K.?" he likes to say. "I make it up as I go along."

One of Rogers charms is that he's so consistently, so gloriously indiscreet—about politicians ("what is she smoking?"), rival energy executives ("he's the ultimate shill"), even his colleagues at Duke ("some of them are way too Republican for me")—that he appears to be winging his way through life. It's a carefully calibrated illusion. "I'm real friendly and open and extroverted, in appearance," says Rogers. "But I'm constitutionally introverted."

Krupp, EDF's leader since 1984, didn't project such a vivid public persona. Yet he was uncommonly driven, intelligent, and shrewd, with an eye for an important idea—environmental economics, or using market mechanisms to drive the green agenda—and the audacity to appoint himself as its champion. Krupp was often attacked by the environmental left because he forged partnerships with industry and pushed for agreements that the left couldn't stand; he had a bias for action. What they called sleeping with the enemy, Krupp called dealing with the world as it is rather than as he wished it to be. Capitalism had gotten us into the climate mess, he believed, and capitalism was the only thing that could get us out of it.

Unless the U.S. embraced a global treaty similar to the one that led to nuclear disarmament—with concrete reduction goals, monitoring, and verification—Krupp didn't see how the world would make any progress on global warming. It was that basic; he had never heard another theory of victory. All the other scenarios amounted to voluntary measures that had been tried and had failed. Even a small carbon tax, which didn't have the votes to pass, wouldn't necessarily reduce emissions. Only a cap could do that, he believed. Only a cap.

The heart of a cap-and-trade program is simple: A mandatory, declining limit on pollution. The controversial and often misunderstood part of the program—the trade—is basically a way to smooth costs by allowing emitters to buy and sell the right to pollute. Trading establishes a price for the commodity and allows innovative companies to profit from going green. Although few outsiders realized it, Krupp had pushed cap-and-trade for sulfur dioxide as a test case, a precursor to the carbon cap he believed would come. Rogers had been an unlikely ally the first time, so naturally Krupp courted him again. Much of Rogers' industry was against him, as were important members of his team at Duke Energy. People throughout the organization were mystified that a utility CEO would make common cause with the greens. Don't get in bed with the enviros, they told him. They'll poison you in your sleep. By November 2006, Krupp could see that the CEO was wavering about committing to USCAP, so he called Rogers and suggested they meet for dinner. At a steak house near Duke's Charlotte headquarters, Rogers made it clear that he needed free allowances and a path forward for coal, or he couldn't stay onboard. He wasn't about to let Krupp know how many allowances he needed. He didn't really know himself.

By the time the plates were cleared, the two were feeling some rapport. Krupp decided Rogers really wanted to do something about Duke's carbon emissions, and that was Krupp's bottom line; either the guy meant it or he didn't. And if he did, Krupp would try to help him get there. If Rogers wanted to be part of a solution, it didn't matter to Krupp that he also wanted to get the best deal for his company. Rogers thought Krupp was smart as hell, and that he had the ability, rare among environmentalists, to see economic problems the way a businessman might. He walked out of the restaurant thinking, I'm really going to do this, if I can cover my flank on a couple of things.

Before long, Rogers had become Corporate America's swing vote on climate. If he supported a bill, he'd bring other power executives and important politicians along with him and it had a fighting chance. If he denounced a bill, that meant it was probably dead. He wanted to fix the climate and make money for his shareholders and keep the lights on for his customers. He wanted it all. Was that even possible? He had no idea.

Throughout 2007 and 2008, while USCAP members were involved in protracted internal negotiations over the fine points of their cap-and-trade blueprint, Rogers was working both sides of the issue: Supporting cap and trade in theory, but doing his best to kill Lieberman-Warner, the cap-and-trade bill that actually did exist. It died, with his help, in June 2008, the same week Barack Obama clinched the Democratic Presidential nomination. After Obama won the election, Rogers could see the climate issue ripening. It was time, he thought, to join the parade.

Rogers wanted to fix the climate and make money for his shareholders and keep the lights on for his customers. He wanted it all. Was that even possible? He had no idea.



Rogers making his case before the House Energy & Air Quality subcommittee in March 2007

The Open Window

As Obama prepared to take office during the worst economic crisis in 70 years, the President-elect promised to "mark a new chapter" in the fight against global warming. "That will start with a federal cap-and-trade system," he said in a video beamed to a climate conference hosted by California Governor Arnold Schwarzenegger on Nov. 18, 2008. "Delay is no longer an option. Denial is no longer an acceptable response."

Environmental leaders were thrilled that Obama was making the cap a top priority. But transition aides were soon telling reporters that the speech was not a signpost to governance. "Barack's video was still part of campaign mode," said a top climate and energy adviser. "It was about sending a message, not setting a timetable for legislative action." No decisions had been made about when or how to proceed.

In mid-January 2009, Rogers, Krupp, Immelt, and Frances Beinecke of the National Resources Defense Council met at Obama's D.C. transition office with transition chairman John Podesta, climate and energy adviser Carol Browner, and economic adviser Larry Summers. Walking into the meeting, the USCAP leaders expected the discussion to focus on the stimulus bill, but Summers stunned them with an argument for fast climate action because uncertainty was freezing investment decisions. "If you give executives a yes-or-no answer they can act accordingly," he said, "but when you tell them you don't know the answer, they tend not to act." That was only one reason to move forward now. "For the next two or three years we're going to have to fight the recession, and we're not going to do it by creating another wave of [information technology] spending," he said. Summers noted that the Japanese economy stagnated for an entire decade because it never found another source of demand. He saw the cap as the crucial demand driver. "It's like two blades of a scissors," Summers said. "Stimulus spending is one blade. And a cap-and-trade mechanism will be the other."

With an advocate for climate legislation moving into the White House, the environmental community saw a window of opportunity and quickly began to overreach. Rogers was unnerved when a coalition of 29 environmental groups—including EDF and NRDC, his partners in USCAP—sent a set of policy prescriptions called "Transition to Green" to the new Administration. It endorsed auctioning rather than giving away the pollution allowances in a cap-and-trade system; he was still hoping to get the allowances for free.

When he read the document, Rogers was beside himself. If EDF and NRDC blocked a USCAP plan calling for free allowances, he was going to walk. The problem wasn't so much Transition to Green; the enviros were always coming out with manifestoes. This one mattered because it was endorsed by EDF and NRDC, and he needed to know that Krupp and Beinecke had his back. So his people put out the word: Rogers wasn't going to sign on to the blueprint unless it gave the power sector 40 percent of the allowances. He also had to satisfy himself that EDF and NRDC would stick to the agreement. Which side were Fred and Frances really on? Rogers was going to find out.

The Blueprint

On Jan. 15, 2009, the USCAP CEOs came to Capitol Hill to unveil their blueprint for cap-and-trade. The schedule was packed: a breakfast with senators, a press conference, and a hearing before the House Energy & Commerce Committee. The breakfast did not go well. "You all should be ashamed of yourselves," said Tennessee Senator Bob Corker, the first Republican lawmaker to speak to the CEOs. "If I was on your board and you came to me with a plan like this, I would fire you." He called their blueprint "a Rube Goldberg scheme" designed for their self- serving interests. The free allowances, he said, were "the equivalent of cash or marketable securities," windfall profits to be stuffed into the CEOs' pockets.

The room was astonished: A wealthy, conservative Republican was using talking points from the left to eviscerate two dozen of the most powerful executives in America. Rogers responded first, a slight quaver in his voice as he explained why the allocation of free allowances was not the allocation of profit. Allowances weren't like marketable securities—Duke wouldn't be able to sell them; they allowed it to operate its plants.

Jeff Immelt spoke last. "I can't let this stand," he said softly. "Senator Corker, I have great respect for you, we'd love to work with you, but I have to tell you that what you said this morning was way too personal. You basically said we're pigs at the trough, and I can't let that stand. We've worked for two years trying to find a way to move things forward. We made an honest effort, and the tone you have taken is just not right."

Rogers had no reason to believe the rest of the day would go any better. The hearing was the first to be run by Henry Waxman since the liberal from Beverly Hills unseated Detroit's John Dingell as Energy & Commerce chairman. On top of that, Ed Markey, the Massachusetts liberal who chaired Speaker Nancy Pelosi's select committee on global warming, took over as chairman of the environment subcommittee, bumping Rick Boucher, a brainy congressman from southwest Virginia. Cars and coal were out of power, replaced by Beverly Hills and Boston.

Like Rogers, Waxman and Markey were easy to caricature. Their real views were more complex. When Waxman began to reach out to key stakeholders on cap and trade, before the Jan. 15 USCAP rollout, Krupp had come in to see him. They talked about the blueprint and discussed the CO_2 reduction targets USCAP would call for: a range of 14 to 20 percent below 2005 levels by 2020. Waxman was dug in at 20 percent but thought USCAP set the floor for what was possible. He was glad important companies were embracing climate action but questioned the wisdom of EDF and NRDC joining them now. Wasn't Krupp losing leverage by cutting a deal so soon? Waxman thought it would be more effective if the environmentalists called for tougher targets than he could deliver.

Krupp explained that other groups would still be out there shouting for more, but that EDF and NRDC had needed to commit to get the USCAP CEOs to yes. He walked Waxman through USCAP's 2½-year negotiation and predicted that industry would be flexible about targets if it could get the free allowances and offsets it needed to defray costs. As they had come up the learning curve together, he said, they had seen that allowances were the key to containing costs, avoiding rate shocks, and making the political deal work.

Waxman and his team were surprised to be hearing this industry argument from an enviro. But Krupp had decided Rogers was right. Free allowances weren't a windfall if you passed their value on to consumers. After consulting with Krupp, Frances Beinecke of NRDC, and other environmentalists who cast their lot with the big corporations in USCAP, Waxman began to see

Krupp defended Rogers' right to put a stake through the Obama plan but challenged him about his tone. "If we want to get a cap," he told him, "you need to be careful not to throw the baby out with the bath water."



Fred Krupp of the Environmental Defense Fund, a longtime champion of the carbon cap

the blueprint as a way to remake the politics of global warming. At the hearing, he praised the CEOs for recognizing that a well-designed bill was "the key to a revitalized economy and our long-term prosperity."

This was the new, improved message: climate legislation not in spite of the economic meltdown, but because of it. "Companies are caught in a dilemma," Waxman said. "They are reluctant to invest in old polluting technologies because they know that tougher regulations are inevitable, but they can't invest in new, cleaner technologies until they know what Congress is going to require." Waxman was using USCAP as a shield against those who said a climate bill would wreck the economy. He would base his bill on the USCAP blueprint and build his coalition from the center—enlisting Republicans if he could.

"Cap and Tax"

When Obama's first budget proposal was released on Feb. 26, it hit Rogers like a boot in the belly. It called on Congress to enact a cap-and-trade program with "a 100 percent auction to ensure that the biggest polluters do not enjoy windfall profits," and assumed the auction would raise $650 billion between 2012 and 2019. The government would spend $15 billion a year to develop clean energy, with "the balance of the revenues … returned to the people, especially vulnerable families, communities, and businesses."

About $60 billion a year would be used to pay for a tax cut. Senate Majority Leader Harry Reid was talking about diverting money to help pay for health-care reform. "Haven't these people heard a word we've been saying?" Rogers asked. He had been explaining for two years why a 100 percent auction was a bad idea, and for the past year Obama aides had been whispering that Obama got it, that he would "pivot." But it still hadn't happened. Rogers thought the President's team was still listening to deep-green people like Carl Pope, then the executive director of the Sierra Club; people who wanted to punish the polluters—which only meant they would be punishing ratepayers because this plan would drive rates to the moon. That was what they wanted: a strong price signal at the retail level.

Obama had conceded as much in a January 2008 interview with the *San Francisco Chronicle,* when he had said that under his plan, "electricity rates would necessarily skyrocket." That would be the effect of a 100 percent auction, so the government would send a check to people to defray those costs. But since coal-dependent states would be paying out more than states that got their electricity from nuclear or hydro, a per-capita rebate would be unfair—it would be a transfer of wealth from the Midwest to the coasts. Rogers didn't think consumers would connect the dots between a government check and higher electric bills. They wouldn't realize the one was supposed to pay for the other. They'd just be pissed off—at Rogers. He got to be the villain, and Obama got to play Santa Claus.

And so the CEO went to war again. Duke set up a climate war room, a rapid-response unit staffed by Rogers's in-house climate PR man, Tom Williams, who knew how to give good quote. As reporters began writing about the budget, Williams sent out an e-mail predicting that it would drive electricity rates up by as much as 40 percent in Indiana and Kentucky. The e-mail's subject line: "COAL STATE STICKUP."

Rogers wasn't the only one reacting badly to the trial balloon. Pennsylvania Congressman Mike Doyle and others charged into Nancy Pelosi's office and told her it would be unacceptable if a penny from cap and trade went to anything other than "solving the energy crisis" (which meant, mostly, shielding their voters and industries from rising costs). Senators from Ron Wyden on the left to John McCain on the right laid into the proposal as well.

Inside EDF, things were getting tense. Krupp defended Rogers' right to put a stake through the Obama plan but challenged him about his tone. "If we want to get a cap," he told him, "you need to be careful not to throw the baby out with the bathwater." Rogers had been calling Obama's plan "cap and tax," which played into the heart of the opposition strategy—persuading America that the cap was nothing more than a "light-switch tax." To Krupp, a cap was different and better than a tax. "We need to keep our eye on the ball," he said. "The legal limit is the thing, not the price on carbon."

The Tag Team

On Mar. 3, Rogers came to Capitol Hill to work both the House and Senate—private meetings with Waxman and Reid and a half-dozen others. He began in the Rayburn House Office Building for his first face-to-face with Waxman. Rogers

PETER MURPHY

was still heated up over the President's auction proposal and worried something like it would be in Waxman's bill. He tried not to bring a lot of expectations into the room, but he saw Waxman as "a tough guy, a liberal guy who wanted a tougher bill than I thought was economically viable." Instead he encountered a diminutive, engaging man, "very inviting and very nice." Rogers was nice, too, Kentucky nice, so their chat was extremely nice. They were nicing each other half to death. Rogers began to suspect that it might not be artificial sweetener.

Waxman said he wanted to show Rogers a draft bill: "I want to work with you on this." Rogers said he would be honored and mentioned that he had been working on carbon legislation since 2001—a long time, by industry standards. He said the 100 percent auction would force him to raise rates, "so I'm the bad guy, and the government's going to send a check to everyone so you get to be the good guy. Don't make me the bad guy—there's a better way to do this. Free allowances are the way."

"I understand exactly what you're saying," Waxman replied. "Making you the bad guy is not what we're trying to do here." To underscore his point, the chairman added, "I'm really going to listen to Rick Boucher," the Virginia coal-country congressman, which was a way of saying he was going to write a bill that coal-fired utilities could support. Rogers was pleased but still wary—"it felt like we'd met at the 50-yard line and shaken hands," he said later.

After Rogers left Waxman's office, he crossed Capitol Hill to join Krupp for a meeting with Harry Reid. Their goal was to discuss legislative traffic; Waxman had announced that his committee would be producing one big bill—cap and trade and energy provisions all rolled together—but on the Senate side, Jeff Bingaman, chairman of Energy & Natural Resources, was pressuring Reid to move an energy bill only, so it wouldn't be "held hostage" to cap and trade.

Rogers and Krupp went through their points—the importance of acting this year, the importance of allowances—and then Reid broke in. "I used to think we had to do the energy bill first and then cap and trade," he said, "but I've decided we should do the energy bill, cap and trade, and the smart grid all at once as soon as we can." Krupp's jaw dropped—and Reid wasn't finished. Looking directly at Rogers, he said, "I don't think we're going to get a strong bill unless we do this through budget reconciliation"—a maneuver that would allow Reid to pass a bill with 51 votes instead of the 60 needed to defeat a filibuster. "I may try to get it done that way."

Rogers blanched—he saw the 60-vote threshold as his insurance that the bill wouldn't go too far to the left and start punishing polluters. He started talking fast, explaining how the industry had hammered out an allocation formula that factored in the carbon intensity of each utility, why that was important to protect consumers in coal states, and why USCAP had adopted it in its blueprint. Reid's eyes were glazing over. So Krupp put up his left hand: Jim, let me take this.

"Look, Senator Reid," he began, "you may think it is a surprise that EDF, NRDC, and other environmental groups support giving these allocations to the utilities. Let me explain why we're taking this position." He described a grandmother in Indiana, living on a fixed income, whose utility would be paying the cost of building solar and wind facilities as well as retrofitting some coal-fired plants for CCS. "That cost is going to be borne by each homeowner, including the grandmother. And if you do 100 percent auction from the get-go, they would also have to pay the cost of buying all the permits. The grandmother would have to pay twice. We didn't think that was equitable. So the USCAP solution is fairer and also more likely to please Midwestern senators concerned about regional equity."

Reid seemed to get the message at last. After the meeting, staffers congratulated Krupp, and Rogers took him aside and thanked him: "Fred, I owe you one."

Taking the House

When the USCAP leaders went to the Roosevelt Room in the West Wing for a late spring meeting with Chief of Staff Rahm Emanuel, they got the impression that he didn't much care about climate change. What he cared about was winning—acquiring and maintaining Presidential power over an eight-year arc. Climate and energy were agenda items to him, pieces on a legislative chessboard; he was only willing to play them in ways that enhanced Obama's larger objectives. He saw no point in squandering capital on what smelled to him like a lost cause. The White House could claim victory if Congress passed a beefy energy bill without a cap—and never mind that doing so could torpedo the

"We want to do this climate bill, but success breeds success," said Rahm Emanuel. "We need to put points on the board. We only want to do things that are going to be successful. If the climate bill bogs down, we move on. We've got health care."



White House Chief of Staff Emanuel was willing to settle for an energy bill without a carbon cap

global deal and delay serious greenhouse gas reductions, perhaps for many years. At the USCAP meeting, Emanuel made his views clear: "We want to do this climate bill, but success breeds success," he said. "We need to put points on the board. We only want to do things that are going to be successful. If the climate bill bogs down, we move on. We've got health care."

Soon after, at the other end of Pennsylvania Avenue, one of Rogers' lobbyists was negotiating with a Markey staffer. They were arguing good-naturedly about the fine points of carbon allowances when the staffer put a proposal on the table. If the utilities got 35 percent of the pie, close to the 40 percent Rogers had been asking for, "would that close the deal?"

The lobbyist thought for a minute. "Yes, I think it would," he said.

"I'll get right back to you," Markey's staffer said. He called his boss, then called the lobbyist back. "Ed would like to hear it from Jim. Would Jim say the same thing to Ed that you said to me?" I think so, the lobbyist replied, and called Rogers, who was preparing for a board meeting in Charlotte. Markey and Rogers got on the phone, and Rogers told Markey that he would accept a 17 percent reduction target if he could get all the allowances he needed. It was something he had already told Waxman. Then Markey called Waxman and told him about the deal. Waxman called Boucher, outlining the proposal without saying where it had come from, and asked him to run it by the utilities. All of which explains why Boucher's chief of staff, Laura Vaught, found herself calling Rogers' lobbyist, presenting as if for the first time the same deal that Rogers had already discussed with Waxman and Markey. As Vaught outlined the deal, Boucher got on the phone. "What does Jim think?" he asked. "Is this something he can say yes to?"

Rogers was at the pinnacle. He was basically negotiating with himself.

The Closing Window

Rogers' endorsement of the Waxman-Markey bill helped win support from other key power executives and secure Boucher's pivotal vote. After Waxman and Markey cut other deals—with midsize oil refiners and agricultural interests—they had enough votes to bring the bill to the floor, but not quite enough to pass it. Obama began jawboning members, Al Gore worked the phones from Nashville, and Rahm Emanuel put aside his misgivings and mounted an effective whip operation. With an impressive last-minute display by Speaker Nancy Pelosi, the bill passed 219 to 212.

And then it all fell apart. Instead of pushing on in the Senate, the momentum dissolved. The bill's passage unleashed ferocious opposition as conservative commentators whipped up members of the rising Tea Party movement, who condemned "cap and tax" at Fourth of July 2009 rallies around the country and shouted down members who had voted for the bill at congressional Town Hall meetings. Seeing the frenzied response, Senate committee chairmen began slow-walking their version of the bill—and the White House, which had decided to push health-care reform ahead of climate and energy, did not press them. As a result, the U.S. delegation went to the U.N. climate conference in Copenhagen without a binding commitment to emissions reductions—a key reason those talks produced no progress toward a new global deal.

At the same time, a new wave of climate skepticism was rolling across the land, propelled by professional opponents of climate action who missed no chance to sow doubt and confusion. The skepticism gave politicians and business leaders who wanted to duck the issue ample reason to do so, even though the science itself remained implacable: As a new assessment by the U.S. National Academy of Sciences affirms, "climate change is occurring, is caused largely by human activities, and poses significant risks for—and in many cases is already affecting—a broad range of human and natural systems."

It wasn't until May 12, 2010, that a new climate bill with even the remotest chance of success emerged in the Senate. Rogers and Krupp were standing alongside Senators John Kerry and Joe Lieberman when they announced their latest attempt to limit U.S. greenhouse gases and boost clean energy production. The senators had hammered out the compromise measure in nine months of talks with Republican Senator Lindsey Graham, but Graham had bowed out at the last minute after Harry Reid—facing a tough reelection campaign in Nevada—suddenly announced that immigration reform would take precedence over climate change. By the time Reid backed down, Graham was gone—and the catastrophic BP oil spill was making the odds of passing a climate bill even longer. Graham had announced that "cap and trade is dead" and now he said the climate debate should be put on hold, in part because of the oil spill. Passing a bill with greenhouse gas limits "has become impossible in the current environment," he wrote in an e-mail to Bloomberg News.

He was alluding to a basic political problem: Expanded offshore drilling was the chip Obama hoped to use to draw oil-state senators into a grand bargain that would also include subsidies for nuclear power and clean coal technology and, in return, a cap on carbon emissions. And though the oil spill was a wake-up call for getting America off of fossil fuels, it also blew up that grand bargain by taking expanded offshore drilling off the table, at least for now.

"Every time things start moving," says Rogers, "something comes along to knock us back." As oil gushed from the broken well a mile beneath the surface of the Gulf of Mexico, the Duke CEO was among those looking for a plan B—a simpler, narrower first step that might have a chance of passage in 2010, despite the unfolding disaster in the Gulf. The window of opportunity seems to be closing for now, Rogers says, but he hopes it might still be possible to win support for a carbon cap that would apply only to the utility sector, which produces nearly 40 percent of U.S. greenhouse gas emissions. Like many energy executives, he needs a steady price signal for carbon to guide his company's investment decisions. "We're going to be replacing our coal fleet anyway," he says, "and rates are going up no matter what. So we need a policy that forces my industry to do the right thing."

Rogers has gone beyond mere profit motive. He's been bitten by the climate bug. He wants to get this done—to make good on all of those high-minded speeches and win the negotiation in the Senate, just as he had won it in the House. After all, his victory doesn't count until the President signs the bill. Even so, Rogers couldn't help but enjoy it when the chief executive of BP, Tony Hayward, took him aside last winter to complain about Rogers and his allies in the power industry. "You guys got everything you wanted," Hayward said, "and we got nothing."

"Well," Rogers replied, "we had a head start." Ⓑ

KEVIN LAMARQUE/REUTERS/CORBIS

The Smackdown Candidate

Former World Wrestling CEO Linda McMahon made her fortune selling the staged battles of Hulk Hogan and The Rock to millions of fans. Now she's selling herself as Connecticut's next senator

By Andrew Rice
Photograph by Andreanna Seymore

Showtime! The contender, dressed in black, was working the crowd amid sporadic chants of "Linda! Linda! Linda!" Wading across the floor of a bustling ballroom, she flashed an arsenal of practiced moves: here, a handshake or a hug, there, a whisper and a sharp nod of her blonde head. It was a Friday evening in May, and some 1,500 delegates had convened in Hartford for the Connecticut Republican Convention, where they would be voting to endorse one of several candidates for an open U.S. Senate seat. Linda McMahon was gripping, grabbing and locking up support. As a competitor, McMahon had the advantage of wealth—she was promising to spend $50 million to win the seat—and an improbable self-made biography. But what really set the first-time candidate apart at this gathering of town bosses and selectmen was her ease with small-bore politicking. She was playing the audience like a seasoned performer.

This was no surprise, considering how McMahon made her fortune: in the raucous, crass, crowd-pleasing world of professional wrestling. Over more than 30 years, she and her husband, Vince, built a scruffy promotion company into a $1.2 billion empire of staged violence called World Wrestling Entertainment, known to fans (and the stock ticker) as the WWE. But while Vince, a blustery showman, was transforming TV programming, giving the world characters like Hulk Hogan and The Rock, and taking a lead role in his own wild spectacles, Linda stayed mostly offstage. "I knew I was more suited to the boardroom," she says, "than I was to the television screen." Now that is changing as she steps into the arena of politics and tries to forge a legacy apart from the family business—an enterprise that, despite its passionate and free-spending following, still operates under a cloud of elite disdain.

It says something about this year's anti-Establishment mood that, even before she walked into the ballroom, the wrestling millionaire was already considered the Republican front-runner. Although Connecticut is a reliably liberal state, the race's Democratic candidate, Richard Blumenthal, kept making high-profile mistakes, and McMahon's supporters were predicting that she would be able to tap the same current that carried unlikely insurgents like Massachusetts Republican Scott Brown into a Senate seat long held by Democrats. "She went from zero and built up that corporation," said delegate Carol Teodosio, who began uncommitted, but had been won over by



McMahon in her Stamford (Conn.) campaign office

McMahon's outsider message. "She can deal with the Senate. She's dealt with testosterone before."

First, McMahon, 61, had to take care of the competition at the GOP convention, which included two Tea Party types, well-known money manager and financial market doomsayer Peter Schiff (campaign slogan: "Schiff Happens"), and volunteer firefighter Vinny Forras, whose principal qualification—he had responded to the World Trade Center on September 11—was touted by supporters wearing yellow fire helmets and carrying a banner image of the smoking ruins. Her most serious opposition came from Rob Simmons, a grayed ex-congressman with a moderate record. Simmons had promised to quit if he didn't win the party's endorsement, and McMahon was trying to drive him out of the race. Already she'd obliterated his early lead in the polls with a fusillade of expensive ads. "You know how much money I've spent on advertising?" Simmons said, as he canvassed the delegates for last-minute votes. "Zero."

Simmons sounded more overwhelmed than defiant, though, and all around him his opponent's financial edge was apparent. The ballroom floor was crawling with buzz-cut young men wearing Bluetooth earpieces and "Linda" golf shirts. "She's got an army here," said one impressed Republican, surveying the scene from the sidelines.

McMahon's foot soldiers were reporting back to a computer-filled war room down the hall, where Ed Patru, a Washington political operative who serves as the campaign's communications director, was counting votes and assessing intelligence. Hearing something he didn't like, Patru barged from the room with an aggravated look. "It's dirty politics out on the floor," he growled. Simmons' supporters, Patru claimed, were spreading rumors that a TV station was about to break news of a scandal from McMahon's past. While it wasn't true, it wasn't unbelievable, either.

McMahon was pitching herself to the convention—and by extension the state of Connecticut—as the very model of a successful Republican businesswoman. Her opponents were replying, in essence: take a look at the business. The field of wrestling is fertile ground for muckrakers. Over the years the WWE has been buffeted by periodic waves of scandal over steroid abuse, premature deaths, and allegations that their product was spoon-feeding raunchiness and violence to children. And at nearly every turn, the McMahon family gleefully embraced an outlaw image, at least on TV, playing a scheming, evil, brawling bunch of cretins in the parallel universe of their wrestling shows. The formula translated splendidly into ratings and revenues for the WWE. But now, as Linda McMahon enters a very different sort of contest, one for the public's approval, she faces a daunting challenge. She has to convince voters that the sordidness was all just make-believe.

Professional wrestling grew out of the freewheeling culture of traveling carnivals. Before Vince and Linda McMahon came along, wrestlers appeared on dingy and disorganized regional circuits, hewing to fraternal traditions with a distinctive vocabulary. The good guys were called "baby faces" and the bad guys were "heels"; the paying customers were "marks," and when they cheered or booed, that was "heat." Wrestlers were never supposed to break "kayfabe," the illusion that all fights were in earnest. If the body slams were faked, however, the rough-and-tumble of the business has always been real. Over three decades the McMahons have seen off all challengers, including some with much deeper pockets, through guile, tough tactics, and most of all, a superior understanding of the audiences' appetites.

The McMahons met as high school sweethearts back in rural North Carolina. They began small, in the 1970s, working for Vince's father, a small-time promoter. They went bankrupt early on after Vince took a risk on financing a stunt—an Evel Knievel motorcycle jump of the Snake River Canyon—that fizzled. But when the McMahons stuck to what they knew, wrestling, they made a formidable tag team. Linda held the purse strings, while Vince pulled the puppet stings, creating characters that roused the crowd—who "got over," in wrestling argot.

Vince, the impresario, is about getting a reaction from everything he does. At press conferences he's been known to declare, "Wall Street can kiss my ass." Linda was the one who smoothed things over and handled the details, playing the firm, financially conversant emissary to network executives and investors. ("I always think of Margaret Thatcher," the wrestler Bret Hart once said when asked to describe her management style.) In her new career, she's proven to be adept at what political professionals call messaging. Sitting one afternoon in her Stamford campaign office, a demure alternative to WWE's gaudy nearby headquarters, Titan Tower, McMahon told me she learned how to communicate in those early days when wrestling was still a barnstorming operation advertised on posters given away to local fire stations. "The only way you actually made money when this business was first beginning was ticket sales for live events," she said. "So you had to really develop a strong grassroots connection."

Back then the company didn't take in any revenues from TV; wrestling promoters would pay stations to broadcast their events during scheduling dead spots, fanning interest in their live matches. But it wasn't long before the McMahons realized that their product was perfect for the new, programming-deprived medium of cable TV. They persuaded the USA Network to start airing a weekly show featuring wrestlers like Hogan, Rowdy Roddy Piper, and the Iron Sheik, and replaced the simplistic heroes-and-heels formula with elaborate storylines—"angles," as wrestlers call them—that unfolded over a series of showdowns, building up to special events like the yearly WrestleMania. Soon, wrestling was the highest-rated draw on cable.

While Vince came up with the characters and charted their shifting allegiances, it was Linda who figured out how to monetize the drama. The WWE trademarked wrestlers' stage names, signature holds, and catchphrases—everything down

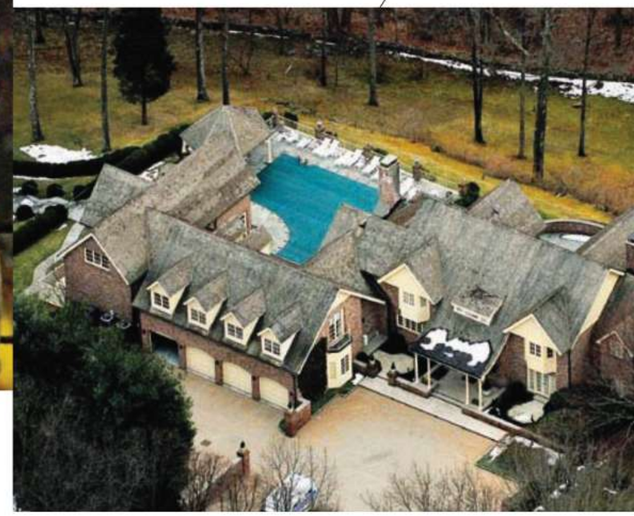
"I do believe that people can definitely separate soap opera from reality" —Linda McMahon



Brawnpower The McMahons in 1980 in the early days of the World Wrestling Federation



Political theater Vince McMahon at WWE's 2001 annual WrestleMania in Houston



McMansion The couple's $11 million estate in Greenwich

FROM LEFT: DAVE ALLOCCA/RETNA/CORBIS; JOHN BARRETT/GLOBE PHOTOS; MORGAN KAOLIAN/AEROPIX

to The Rock's distinctive cocked eyebrow—and licensed them to market T-shirts, action figures, books, and movies. Linda helped launch the brand into pay-per-view events, now a major source of revenue. When state athletic commissions began to pressure the business with regulations and taxes, it was Linda who came forward with the heretical public admission that wrestling was just an act, no more a sport than a magic show. "We got a lot of pushback from some of the older guard," she said. "But that was really the launching point for the company to start moving into more mainstream entertainment."

As the WWF's brand of entertainment grew in popularity, however, it came under attack from the self-appointed forces of decency, people like Senator Joseph Lieberman and the conservative watchdog L. Brent Bozell III, who called the McMahons "despicable people." The McMahons weren't deterred. Vince created a send-up group called Right to Censor, and told *Playboy* that he found Lieberman "scary." (Bygones appear to be bygones: Lieberman, an Independent who holds Connecticut's other Senate seat, recently said he'd consider endorsing Linda McMahon.) A more serious threat, during the 1990s, came in the form of the WCW, a rival league financed by cable baron Ted Turner, who stole Hulk Hogan and many other marquee performers away from the McMahons. Vince responded by dispensing with Hogan's kid-friendly style of cartoonish combat, emphasizing darker characters like the beer-swilling braggart "Stone Cold" Steve Austin, the macabre Undertaker, and the masked fiend Mankind. During this period, the so-called attitude era, the onscreen action became increasingly bloody and risqué, with angles featuring Satanism, sexuality, and smackdowns of scantily clad women.

The biggest heel of the attitude era, as the story developed, was Vince McMahon himself. He played a caricature of a Machiavellian wrestling league boss and occasionally descended into the ring to do battle with his archenemy, Steve Austin. Over time, the rest of the McMahon family got into the act. Son Shane, who in his day job headed the company's digital strategy, once took a 50-foot leap from scaffolding to the ring during a fight with the wrestler The Lethal Weapon. Daughter Stephanie, now the company's vice-president for creative development and operations, played a rebellious brat who cavorted with the hated Hunter Hearst Helmsley, or Triple H, and was often serenaded by crowds chanting "slut, slut, slut."

The McMahons say the routines were all in good fun, if not good taste. "It was almost one of the first reality series, if you would," Linda said. "It was real people, who were a real family, having these interactions in a ring." The bawdier the stories got, the more the McMahons were rewarded by the audience—and the markets. In 1999 the WWE, which changed its initials after a trademark suit by the World Wildlife Fund, went public. The McMahons, who held 83 percent of the company, were soon worth almost $1 billion on paper. (The stock has since had ups and downs, although it now trades just below its original offering price.) The company also absorbed the stumbling WCW. Attitude ruled.

A decade later, the family's exhibitionism is returning to haunt the McMahon campaign. Linda never much liked to be on camera, but her rare appearances—the one where Vince drugged her so he could frolic with one of his "divas," the one where she slapped Stephanie for plotting against the family—were memorable. The WWE has tried to scrub all evidence from the Internet, but McMahon's opponents are finding ample material to work with.

"I really don't think anyone in Sacramento expected Arnold Schwarzenegger to walk into the capital ... shooting machine guns out of each hand," McMahon told me. "I do believe that people can definitely separate soap opera from reality." Still, part of Vince McMahon's genius has been his facility for blurring the lines between the two. In the 1990s, for instance, he fought a bumpkin character called "Billionaire Ted" in the ring, and at times the family's real-life storylines have turned distinctly surreal. In 1999 the onscreen character Stephanie McMahon was married to Triple H in a ceremony at

a Vegas drive-through chapel that occurred while she was unconscious. Four years later, Stephanie got married in actuality, while happily awake, to Paul Levesque—better known as the wrestler Triple H. "That was life imitating art," Linda said.

"It's the wrestling business," says columnist Mike Mooneyham, co-author of *Sex, Lies and Headlocks*, a history of the WWE. "Sometimes it's hard to differentiate reality and fantasy."

The line gets decidedly blurry when it comes to the character of Vince McMahon. A library of tell-all books, including Mooneyham's, depicts him as a visionary who nonetheless bears similarities to the tyrannical figure he plays on TV. WWE wrestlers are employed only as independent contractors without health benefits, and their salaries, determined by their drawing power, start at a minimum of $75,000 and range up to $1 million a year, though they can make substantially more with bonuses. McMahon maintains tight control over wrestlers' appearance schedules, career arcs, even their names, and he makes and discards stars with ruthless decisiveness. He's made plenty of enemies in the process. *Ring of Hell*, a 2008 book by Matthew Randazzo V, quotes numerous named and unnamed former WWE employees who say that Vince McMahon has encouraged a workplace culture of rowdiness, infighting, and rampant abuse of drugs, both recreational and performance-enhancing. "These books are written by authors who benefit financially from sensationalizing WWE's past," says company spokesman Robert Zimmerman. "Neither Mr. McMahon nor the WWE intend to comment on wild allegations attributed to unnamed 'sources' contained in poorly researched books."

No one disputes that the McMahons rose to wealth on the backs of freakishly muscled men. For years the company has been dogged by scandals over steroids. In the early 1990s a series of federal investigations implicated stars like Hogan and Roddy Piper. And Vince, who admitted to having used steroids himself before they became illegal, was charged with conspiracy to distribute. He was acquitted at trial, and the company enacted a steroid testing program. It was abandoned after just five years. In 2007 testimony to a congressional committee, Linda McMahon said this was done, among other reasons, to create "a level playing field" with the WCW, Turner's organization. "He had no drug testing of any kind, and the fact was that he was paying talent much more," she told me. (There is some dispute about whether the WCW did actually test.) "We had come off the trial, we had good solid superstars, and we didn't think it was an issue."

It was only a decade later, after the death of wrestler Eddie Guerrero from a heart condition likely exacerbated by steroid abuse, that the WWE enacted a new drug policy. In a preliminary round of testing, 40 percent of its roster turned up positive. Vince said he was surprised. At first, the company's new rules had significant loopholes. Wrestlers were allowed to perform while serving their suspensions for drug use, on the theory that sitting out was a lesser punishment than being beaten in the ring for no pay. Later, after the wrestler Chris Benoit murdered his family and hung himself, leaving behind a steroid stash, the policy was tightened. Now wrestlers are barred from the ring after a positive test, their names are announced, and contracts are terminated after a third offense.

Despite the new policy, the congressional investigation concluded in 2009 that the WWE had "not taken adequate steps" to address steroid use in its ranks. In his testimony, Vince McMahon made it clear he was not convinced that such performing-enhancing drugs were even dangerous, saying "the FDA hasn't bothered to tell me or anybody else." The company chairman, who cuts a remarkably bulging figure for a 64-year-old, also refused to answer when asked under oath whether he'd used steroids in the prior 11 years. "Mr. McMahon believed that questions invading his personal and medical privacy were inappropriate and offensive," says Zimmerman.

Although there's been some scaremongering, research has linked steroid use by athletes to liver, cardiac, musculoskeletal, and reproductive system damage, as well as psychiatric effects. When I asked Linda McMahon about the issue, however, she said she shared her husband's doubts. "There's some evidence sometimes of muscle disease, or cardiac disease, but it's really hard to know because you didn't know the condition of the performer's heart, or whatever, prior to," she told me. "So I still don't think we know the long-term effects of steroids. They are continuing to study it more and more, but I don't believe there are a lot of studies out there today that are conclusive."

For all their on-camera posturing against the elites, the McMahons have long been engaged in a flirtation with the forces of respectability. Over the years the WWE has tried to translate its brand to mainstream ventures like a football league and a Times Square theme restaurant. Both were expensive debacles. The company is currently expanding into moviemaking, signing up former Oscar nominees like Ed Harris and Patricia Clarkson to star alongside wrestlers. The films are part of a broader push to tone down the WWE's attitude. After years of defending the company over its racy content, which once prompted advertisers like Coca-Cola to pull its ads, it was apparently Linda and Stephanie who decided it was time for less misogyny and gore. Revenues have been hit by the recession, as well as by competition from the authentic blood sport of mixed martial arts, and the McMahons calculated that audiences and advertisers want something more family friendly.

The McMahons own an $11 million Greenwich estate and have become accepted members of Connecticut society. Lowell

New angle McMahon has pledged to spend $50 million on her campaign



PHOTOGRAPH BY ANDREANNA SEYMORE FOR BLOOMBERG BUSINESSWEEK

“She’s got a rough road ahead” —former Connecticut Governor Lowell Weicker

P. Weicker, a former GOP senator and governor, is a member of WWE’s board. The current governor, Jodi M. Rell, paved the way for McMahon’s entry into politics by appointing her in early 2009 to the state board of education, over the objections of some in the legislature who questioned her wrestling background. McMahon told me that brief experience gave her a taste for public service, which matured into a desire to run for the Senate as she watched President Barack Obama enact policies that encumbered entrepreneurs with taxes, regulations, and obligations to provide health-care benefits. “It was just one thing after the other, after the other,” she said. “We need, I believe, more representative senators and congressmen and women who are more in tune to the people who sent them to Washington.” She’s pro-choice, against repealing President Bush’s tax cuts, and skeptical of the bill sponsored by Senator Christopher Dodd (D-Conn.) that would place new rules on the banking industry and create a consumer protection agency, which she calls “just another added layer of bureaucracy.”

Although the WWE has sponsored voter registration drives, and McMahon appeared alongside The Rock at the 2000 GOP convention, people who know her say her interest in the Senate came as a surprise. “No, I didn’t ever sense that this is the direction that she wanted to go in,” says Weicker, an admirer who is nonetheless unsure if McMahon’s prepared for the harsh business of campaigning. “She’s already seen enough to know that she’s got a rough road ahead.”

In her short time in politics, however, McMahon has shown herself to be a formidable combatant. When she launched her campaign last September, her initial target was Dodd, a Democrat who was expected to run again for his seat. She aired a series of commercials attacking the senator as an out-of-touch incumbent who was beholden to special interests. Facing declining poll numbers and the prospect of a free-spending opponent, Dodd dropped out of the race in January, making way for a far more popular Democratic candidate, Richard Blumenthal, the state’s long-serving Attorney General.

Blumenthal’s entry to the race seemed to make McMahon’s challenge far more difficult, but in May The *New York Times* rocked the campaign with a front-page story describing a series of occasions in which the Democrat, who served in a stateside Marine reserve unit during Vietnam, seemed to imply that he’d actually fought in the war. Suddenly, McMahon wasn’t the only candidate with phony battles to explain. In the aftermath, an item posted on her website—and hurriedly taken down—crowed that her campaign had planted the damaging story, although *The Times* asserted that it did its own digging. McMahon’s spokesman says the campaign’s involvement with the leak was limited to sharing research with the newspaper, including a tape of one of Blumenthal’s appearances where he apparently misrepresented his record. The *Times* got its own copy of the tape. “We made a strategic decision before the convention to put our fingerprints on this story,” Patru says. “We believed it would send a message to the delegates.”



Still, a poll conducted by Quinnipiac University in late May, after the news of the Vietnam flap sank in, gave Blumenthal a 25-point lead and showed that more voters had a negative than a positive view of McMahon, an unusual and troublesome result for a first-time candidate. Eric Schultz, a spokesman for the Democratic Senatorial Campaign Committee, says that in McMahon, Republicans have “a candidate who made her millions peddling sex and violence to kids, hiding widespread steroid abuse, and sending her employees into dangerous situations in exchange for their glory and her profit. Democrats chose a crusading Attorney General with a long record of delivering for Connecticut families. I’d take that matchup any day of the week.”

McMahon’s supporters are undaunted and confident the gap will close once an onslaught of commercials allow voters to get to know her—and her opponent—a little better. At the state convention, Republicans were positively giddy over Blumenthal’s embarrassment. Many wore stickers emblazoned with the Attorney General’s face and the word “LIAR,” and jokes about ersatz valor abounded.

The endorsement vote, when it came, was seemingly about as rule-bound as a wrestling match. The candidates and their supporters worked the crowds until the very last minute, twisting arms and striking deals. After the first round, with McMahon close to the 50 percent threshold she needed, the presider announced, bafflingly, that everyone would now have a chance to change their votes. A cascade of delegates came forward, and one by one the announcer called out shifts to McMahon. With the prize within reach, the whole McMahon family—which has stayed far in the background for the campaign—appeared on the floor. Vince was there, spry and broad-shouldered in a light gray suit, and so were Triple H and Stephanie, looking very pregnant with the couple’s third child, and Shane, who recently left the WWE and has been rumored to be exploring several sports-related investments. Swarmed by cameras, the clan clustered around Linda in disciplined silence, ignoring all questions from the throng.

Linda nervously bit her bent finger; it was hard to keep count of all the vote switches. “One more, right?” Vince said, as yet another was called out. When she reached the magic number, Linda silently pumped her fist, and then led the entire scrum on an impromptu procession across the ballroom. The presider scolded her for creating an undignified hubbub, but her audience loved it, clapping and shouting her name.

McMahon accepted the endorsement beneath an arch of red, white, and blue balloons. She graciously thanked Rob Simmons, who a few days later announced he was suspending his campaign, and took aim at the wounded front-runner, Blumenthal. “I venture to say,” she declared, in her slight Southern twang, “we’re going to land a smackdown on him come November.” To her side, Vince beamed. The character was getting over.

“My family has not been part of this campaign or anything, [but] I wanted my family there at the convention,” Linda told me a few days later. “It was a great night. It was not political theater, it was family emotion. We have a strong, close-knit family ... despite all the dysfunction we’ve displayed over the years on television.” B



AIG Chairman Harvey Golub as
Thomas Jefferson (photo illustration)

AIG's Declaration of Independence

The botched Prudential deal may not be another blow to the crippled, government-supported insurance giant as much as a sign of a tenacious new board motivated to save the company. So sit tight, taxpayers, getting your money back could take a while.

By James Sterngold and Hugh Son

American International Group's $35.5 billion deal to sell the AIA Group, its main Asian insurance operation, to Prudential Plc of the U.K. collapsed on May 31 when the insurer's board refused to cut the price. The sale was seen as critical to the firm's ability to begin repaying the U.S. government's $182.3 billion bailout, and its failure was a setback for CEO Robert Benmosche, who had agreed to a lower price, only to be overruled by his board.

Bruce Berkowitz, however, was delighted.

AIG may have become synonymous with recklessness and the global economy's near-death experience in 2008, but for Berkowitz it's pure gold, and the company's luster only grew brighter with the failure to sell AIA—no matter how many headaches it causes the government. For months, says Berkowitz, who manages the $16.5 billion Fairholme Fund, he spent six hours a day studying the battered insurer and bought more than 30 million shares. He now ranks as the largest private holder of the company's stock. Only the U.S. Treasury, which has a nearly 80 percent stake, owns more. The government just wants its money back; Berkowitz says he expects to double his.

"I've got the greatest analysts in the world working for me," says the Miami-based investor, who in January was named stock manager of the decade by Morningstar. "There's the GAO, the New York Fed, the Treasury, Congress, all the advisers they've hired. And guess what, they're working for me for free. I mean, I don't think people appreciate what the government has put into this. If I'm wrong I don't deserve to be in business."

Berkowitz knows he is making a contrarian bet. He usually concentrates his investments in a small number of stocks in industries he knows, from insurance and banking to energy and telecommunications, and admits to being obsessive about his research. He doesn't like AIG merely because it is a ward of the state. He likes it, he says, because it has been transformed by good managers—and especially by a new, more independent board of directors, with several of its members appointed by the government. "AIG's going to prove to be one of the great restructurings in corporate history and the board is a big part of that," says Berkowitz. "They're doing a great job. They're taking their time."



Golub says AIG will not let the government set the agenda for restructuring

A little more than a year and a half after the collapse of Lehman Brothers, amid nonstop debate, criticism, and anxiety, many of the government's most controversial financial rescue programs appear to be paying off. While the markets have been volatile, the economy is growing again, creating jobs. Stocks and some housing prices are up, returning many companies to profitability. Bank of America, Goldman Sachs, Wells Fargo, and even General Motors have been repaying some of the hundreds of billions of dollars in bailout funds, and the Treasury announced last week that it realized $1.3 billion in profit on the first sale of Citigroup shares it had acquired.

Of all the wounded firms, AIG has always stood apart. It is the only company to receive money from a special Treasury facility called the "Systemically Significant Failing Institutions" program, and that is just one of its many life-support systems. Even as the firm gets the bleeding under control, skeptics abound. AIG's new board has privately expressed its own concerns about the firm's viability, people with knowledge of the discussions have said. Elizabeth Warren, chairman of a congressional panel overseeing the bailouts, said last month that some AIG units might have to file for bankruptcy to speed recovery.

Cliff Gallant, an analyst at Keefe Bruyette & Woods, wrote a report in late April saying that the insurer's shares, which have traded as high as 44.51 this year, are worth 6 at best, and are possibly worthless. The government's plan to sell off its 79.9 percent holding, he added, "may not be executable." That assessment so concerned AIG's outside directors that they ordered their own review, according to someone with knowledge of the discussions who asked for anonymity because the

The Name-Change Game



Of all of AIG's problems, the stigma of its brand is not insignificant. Who, after all, wants to do business with a company whose name is shorthand for the near collapse of the world financial system? So AIG has been rechristening various units. The fund management arm was renamed PineBridge Investments, the U.S. auto insurance unit is now 21st Century—both have since been sold—an annuities business is called Western National Life, and the core property-casualty company has been rebranded as Chartis.

meetings were private. This analysis, a single page of bullet points, disputed some of Gallant's assertions while conceding that AIG's book value, a critical element in any plan for weaning AIG from federal support, may face "a number of risks."

Days after Lehman Brothers was allowed to fail, AIG received the largest and most complex government rescue of all. Policymakers were concerned about its vast size–it had about $1 trillion in assets at that time–and feared that losses suffered by its vast network of counterparties might imperil the global financial system. Because of "the risks AIG poses to the economy, the most effective thing to do is to make sure the firm can be restructured over time," Treasury Secretary Timothy Geithner said at a congressional hearing in early 2009.

Having saved it, the government has had a difficult time figuring out when and how taxpayers will be repaid. AIG's board, led by Chairman Harvey Golub and other corporate veterans with deep experience in rescue operations, is asserting itself and steering the insurer toward what it hopes will be long-term health. That was evident this past weekend, when the board rejected the revised Prudential deal worked out by Benmosche. Prudential had sought to cut its offer to $30.4 billion after shareholders complained it was overpaying. Not only is the board standing up to its CEO–despite the potential embarrassment for Benmosche, there is no indication that either he or the board is contemplating a divorce–it also says it will not give the government preference in repayment of its equity over the minority shareholders who were almost wiped out during the crisis.

Golub, the former chairman of American Express, said in an interview that the company was setting its own agenda, not letting the government set it. "We're a Delaware corporation, we operate under Delaware law and our responsibility is to all shareholders," he said. "We'll come up with the best restructuring plan we can, one that makes sense for all shareholders. The plan has to be acceptable to all constituents."

Several months ago the Treasury gave AIG a repayment strategy, a brief PowerPoint presentation, according to a person with knowledge of the plan. It proposed repaying the Fed loans first with the proceeds of the sale of two overseas insurance businesses for $51 billion, assuming those deals closed on schedule. Then, the Treasury proposed converting its billions of dollars in preferred shares into common stock and selling them over a two-year period. The Treasury asked for a response in June. Golub says there is no time pressure. "If it takes until August, it takes until August," he says. "If it takes until next year, it takes until next year. We don't have a time frame, but the board would like it done as quickly as possible."

That represents a significant shift. When Edward Liddy, who had been chairman of Allstate until 2006, took over as AIG's $1-a-year CEO in September 2008, he had to deal with problems beyond merely navigating markets in free fall and tens of billions of dollars in losses. He also faced crushing payments of more than $10 billion in the first year for the Fed's initial $85 billion rescue loan. Then there were the government's restrictions on compensation for top executives, as well as on bonuses, perks, and lobbying.

The terms of his service were clear–his job was to remove the firm from the government's embrace as swiftly as possible. "The mess we're in is solvable," Liddy told employees, largely by selling some businesses quickly so AIG could repay the loan. The initial plan involved selling off more than two-thirds of the company. "Every day we don't do something, it will hurt us."

Months later the company said that the rushed sales would not yield enough cash to ever fully repay the government. Yet waiting for the company's profits to grow enough to return the taxpayers' money wouldn't work either. A new strategy was needed.

So Liddy was replaced by AIG's fifth CEO in five years, Benmosche, the former chairman and CEO of MetLife, who did not agree to a salary of $1. His pay package provides $10.5 million a year, and he threatened to quit last year if the government's pay czar, Kenneth Feinberg, did not ease pay cuts on some top officers, according to a person with knowledge of the discussions. Feinberg held his ground and Benmosche stayed.

The government's initial emergency loan has ballooned into a six-part, $182.3 billion package of loans and loan commitments from the Fed and investments by the Treasury in three different types of preferred stock. The components include a $60 billion credit line from the Fed, $52.5 billion of Fed money used to purchase the toxic-mortgage-linked assets that nearly destroyed the insurer, and a further $69.8 billion from the Treasury for the preferred stock.

The company that was on a tear to unload businesses is now engaged in a long-term workout, its priorities rearranged. The government has tacitly endorsed this by relieving AIG of the punitive repayment terms; the firm is not being forced to pay roughly $5 billion a year in dividends on the government's preferred shares, according to Warren, the congressional overseer, and the insurer has been allowed to accrue an additional $5.75 billion in unpaid interest on Fed loans as of Mar. 31.

Since the credit crisis, AIG has sold 26 businesses for $12 billion, pocket change for a firm as huge as AIG. It still has approximately 400 companies that operate in 130 countries with a total of $864 billion in assets as of Mar. 31. If AIG succeeds in selling the two overseas businesses, AIA and another called Alico, that would remove about a third of the remaining assets. AIG has 96,000 employees, 20,000 less than it had at its peak. The market value of its outstanding shares has dropped from $186.4 billion at the end of 2006 to about $5 billion.

The notorious division that caused most of the losses, AIG Financial Products, is still operational. Most of its worst performing assets–tens of billions of dollars of collateralized debt obligations and other asset-backed securities–were taken over by a specially created vehicle financed by the Fed to remove the risk from AIG's books. The insurer has since been busy winding down what remained of AIG Financial Products. According to the Treasury, the unit cut the notional value of its derivatives book to $755 billion from $2.7 trillion at the end of 2008. By the end of this year the remaining derivatives positions will be transferred to other divisions and the unit closed.



Industry veteran Benmosche is AIG's fifth CEO in five years

Instead of focusing on raising cash for the government, then fixing the remaining insurance businesses, Benmosche and the more activist board that chose him are now engaged in a methodical restructuring, intending to leave

OPENING SPREAD: JEFFERSON: CORBIS; GOLUB: CHIP EAST/BLOOMBERG/LANDOV. OPPOSITE PAGE: CHIP EAST/BLOOMBERG/LANDOV; THIS PAGE:YURI GRIPAS/REUTERS



a vibrant business even after the government is repaid. The board has been restocked with veterans of long, difficult bankruptcies, including a restructuring committee chaired by Douglas Steenland, who saw Northwest Airlines through a bankruptcy as its CEO. Also serving on that committee is Robert Steve Miller, who was CEO of the auto parts maker Delphi during a bankruptcy; Henry Miller, head of a banking firm that specializes in restructurings, Miller Buckfire & Co.; and Morris W. Offit, chairman of an investment firm. Their goal is to build a company that will produce healthy returns for all shareholders, according to Golub, reclaiming the company's standalone investment-grade credit rating and then repaying the government in full.

To do that, Golub says the company might seek yet another improvement in the terms of its bailout before moving on to repayment. In the past, that has meant replacing part of the government's debt with equity or cutting interest terms. Such changes would constitute the fifth easing of those terms. Repayment would be delayed in favor of building AIG for the future and providing more value for minority shareholders, like Berkowitz' Fairholme Fund. "We would follow whatever course of action would accomplish our business objectives, whether it's one step, two steps, three steps, four steps, to accomplish those objectives," Golub says. "We don't care how many steps it may take."

The government is not objecting. At a hearing of the congressional panel overseeing bailout spending last week, Jim Millstein, Treasury's chief restructuring officer and a former investment banker, acknowledged that "it will take time to repair fully the damage to" AIG's franchises. "That said," he went on, "the company's progress to date is encouraging."



Treasury's Millstein says AIG's progress is encouraging

One of AIG's recovery strategies has been to seem less AIG-like. The fund management arm was renamed PineBridge Investments, the U.S. auto insurance unit was rebranded as 21st Century, and AIG said it would change the name of an annuities unit to Western National Life.

The core property-casualty company that, if all works out, will survive the rescue, has been renamed Chartis. It had $879 million in operating income in the first quarter, as AIG reported overall net income of $1.45 billion. The company said that its other core business for the future is SunAmerica Financial Group, which specializes in retirement products.

Not everyone is so sanguine about AIG's health and the prospects for taxpayers getting all their money back. Officially, Treasury has said that it may suffer losses of $45.2 billion on its AIG investment. Elizabeth Warren noted in a hearing last week that AIG is finally reporting profits again only because it is not paying $5 billion in dividends on the preferred shares owned by the Treasury, which equals nearly a year's worth of profits, based on how the insurer did in the first quarter.

After Gallant of Keefe Bruyette & Woods testified about his concerns, Benmosche rejected the pessimism as uninformed. At the hearing he told taxpayers, "you'll get your money, plus a profit." He said he based his view on the increased health of the company, which could earn as much as $8 billion next year.

Golub said AIG has the luxury of time to develop the profitability of the businesses while working to repay the government. "If we concluded that maximizing shareholder value meant that we should hold on to a business for longer periods, we would do that," he says. "If we thought we would maximize shareholder value by selling off businesses more quickly, then we would do that."

In his testimony, Gallant said that it was only the government's support that gave AIG those options, and the support was contingent on a belief that AIG's failure could destabilize the financial system. A person with knowledge of the Treasury's thinking reiterated that concern. "The most important thing is to keep it stable so it doesn't cause another conflagration, and to exit as quickly as possible consistent with that goal," he said.

Gallant questioned how long the government would cling to that view. "As systemic risk fades, the treatment of AIG is likely to change," he said.

If that raised questions for Gallant about AIG's future value, Berkowitz said he found it a bedrock of his confidence that the government will be repaid by the end of 2011 and that shareholders will prosper. "Ultimately, I don't think the Treasury's in the business of giving money away and it's going to see that it gets the real value there," he says. "This has to be the most complicated restructuring in the history of the U.S., and when it's done we'll all be very proud of it." B

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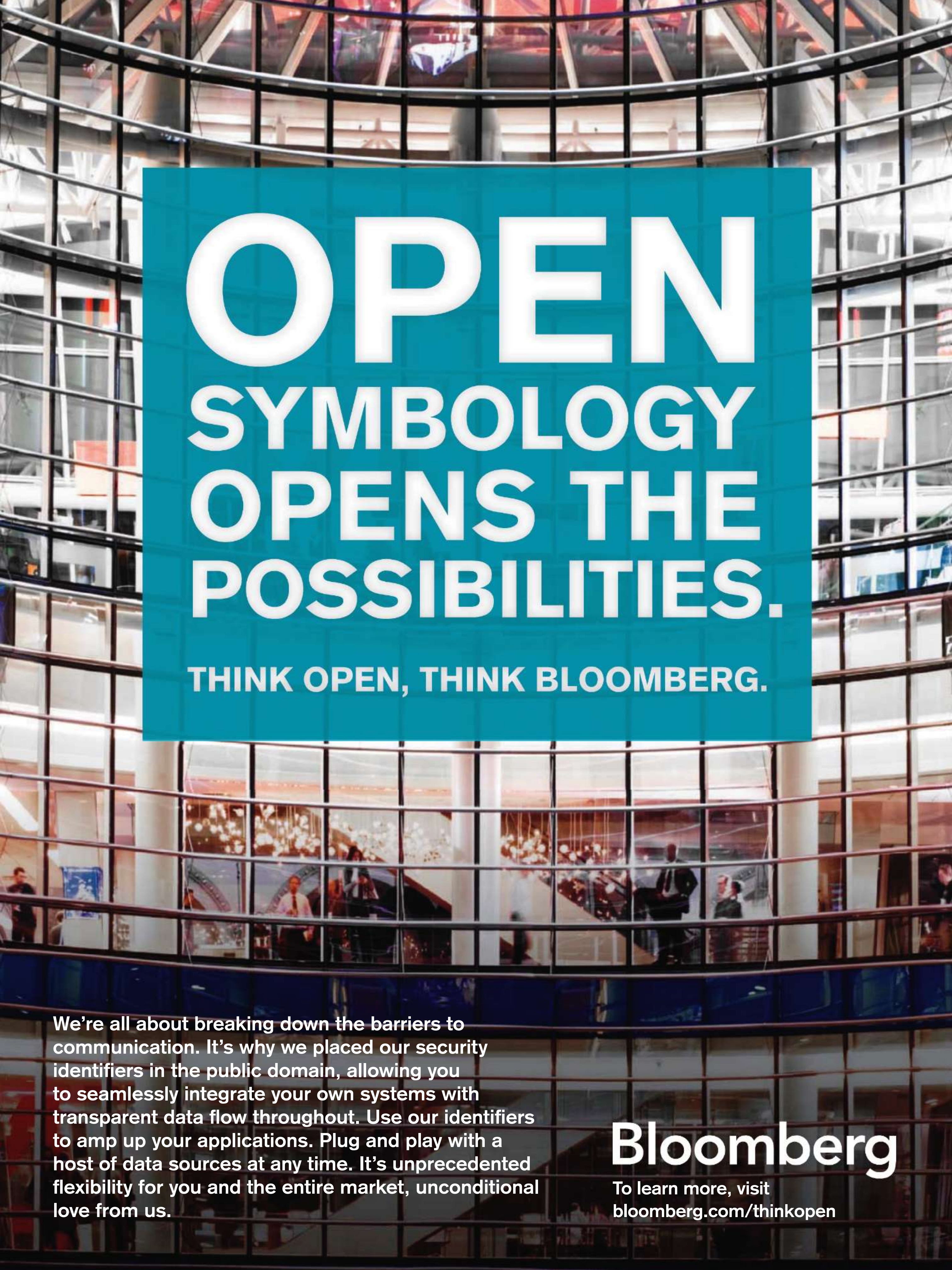
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The World Is Watching

A spectator's guide to the World Cup: Whom to root for–or against–and who has the coolest uniforms. *By Roger Bennett*

FROM TOP: GETTY IMAGES; IAN WALTON/GETTY IMAGES

Etc. The World Cup



South Africa's projected visitors during the tournament: 373,000

The world of soccer functions independently of the international marketplace. Of the 32 countries lining up for this year's World Cup, which runs from June 11 to July 11, only two of the world's five largest economies are serious contenders. While only one BRIC nation is among the field, economically imperiled countries Portugal, Italy, Greece, and Spain are represented.

Although soccer is nowhere near the dominant sport in the U.S., one of the more remarkable phenomena of the last World Cup was that ratings continued to swell even after the U.S. was knocked out. This year the Americans should progress into the next round, but probably no further. Whom should the typical American spectator root for, then? Fans choose a team for all sorts of reasons, ranging from its star players to the stylishness of its jerseys. Some just pick the one that seems the most quirky. What follows is a purely subjective analysis of the 32 teams that most (and least) deserve your support, based on on-field talent, off-field intrigue, socioeconomic peril, historical turmoil, and, yes, couture. Simply put: Fear Brazil, back the plucky Serbs, and don the fetching green of Cameroon. As a tiebreaker: Bet on the country with more debt.

A League of Their Own



The U.S.
Odds: 80-1 **GDP:** $14.3 trillion
Players to watch: Landon Donovan and Clint Dempsey will forage for goals while Tim Howard tries to keep them out at the other end. **The bottom line:** The Americans' opening match against England will receive all the hype, but they'll still need to get past Slovenia and Algeria to advance.

The Long Shots

These teams, in the words of the onetime Scotland manger Tommy Docherty, may be "home before their postcards."



New Zealand
GDP: $118 billion **Odds:** 2,000-1
Player to watch: Defensive anchor Ryan Nelsen. **The bottom line:** The ultimate pub team. Scoring a single goal will be a monumental achievement.



North Korea
GDP: $28.2 billion **Odds:** 2,000-1
Player to watch: Captain Hong Yong-Jo, a striker for lowly Russian team Rostov, is the only representative who plays professionally in Europe. **The bottom line:** Kim Jong-Il has decreed that only edited highlights will be broadcast at home, ensuring that the North Korean side appears dominant irrespective of the score.



South Africa
GDP: $287 billion **Odds:** 125-1
Player to watch: Pigtailed midfielder Steven Pienaar. **The bottom line:** Possibly the least talented host since *The Bachelor*'s Chris Harrison, South Africans hope the tournament has the same economic effect it has had on past host countries. In 2006, for instance, the German economy outperformed the rest of the world by 9 percent before the first ball was even kicked, and then continued to spike after the final.



Uruguay
GDP: $31.5 billion **Odds:** 80-1
Players to watch: Flaxen-haired hit man Diego Forlan and defender Diego Lugano. **The bottom line:** Loaded with offensive potency, but too inconsistent and undisciplined to make an impact.

The Credit Risks

What could a deeply indebted European nation hope for more than the economic boost that comes with World Cup victory? ABN-Amro has calculated a 10 percent average stock market gain for winners of the last three World Cups. Unfortunately, the average decline for the losing finalist was a staggering 25 percent. Supporting these teams may not be worth the risk.



Greece
GDP: $331 billion **Odds:** 150-1
Player to watch: The star of the team is actually authoritarian German coach Otto Rehhagel, known as "Rehakles," a mashup of his name and Heracles, the son of Zeus. **The bottom line:** Little hope exists—on or off the field—for these practitioners of unattractive soccer.



Italy
GDP: $2.12 trillion **Odds:** 14-1
Players to watch: Goalkeeper Gigi Buffon, midfielder Andrea Pirlo, and his more aggressive sidekick Daniele De Rossi. **The bottom line:** Italy's aging squad was politely referred to as "experienced" before it won the 2006 World Cup. Many of the same players are back, and now they're legitimately old. Still, UBS Wealth Management Research's quantitative analysis picked the Azzurri as a likely winner.



Portugal
GDP: $228 billion **Odds:** 22-1 **Players to watch:** Cristiano Ronaldo, the magnificent yet petulant thoroughbred; winger Nani; and Liédson, a recently naturalized Brazilian striker. **The bottom line:** Despite the

MASCOT: LENNART PREISS/AFP/GETTY IMAGES; DROGBA: HAMISH BLAIR/GETTY IMAGES; VILLA: DENIS DOYLE/GETTY IMAGES

The Cream of the Cup

Villa was recently sold to Barcelona for $49 million

The world's best—and some of its richest—players will be competing for a wealth of pride next week



Didier Drogba
National team: Ivory Coast
Club: Chelsea
The balletic, one-man wrecking crew is one of *Time* magazine's 100 Most Influential People



David Villa
National team: Spain
Club: Barcelona
Teammate Fernando Torres gets more press, but Villa scores in two of every three appearances for La Furia Roja

The Groups Two teams from each will advance | **GROUP A:** *South Africa, Mexico, Uruguay, France* ▶ **GROUP B:** *Argentina, Nigeria,*

presence of star names throughout the team, the Portuguese struggled to qualify. Yet an ING study revealed that the average Portuguese citizen would willingly contribute $450 in exchange for victory.

Spain
GDP: $1.46 trillion **Odds:** 4-1
Players to watch: David Villa, a striker whose modest demeanor masks a ruthless talent, and Barcelona's Smurfish mono-named midfield tandem Iniesta and Xavi. **The bottom line:** Spain has repeatedly dazzled early in international competition, only to implode once the elimination round begins. That said, they came out on top of Reuters' poll of global economists to win it all.

The Unoriginals

Picking these obvious contenders demonstrates a distinct lack of imagination.

Brazil
GDP: $1.57 trillion **Odds:** 9-2
Players to watch: Kaká, who was sold to Real Madrid last year for $93 million; ruthless striker Luís Fabiano; and plundering defender Maicon. **The bottom line:** Ranked No. 1 in the world, the team's physical defense and quick counterattack could bring an unprecedented sixth championship.

Germany
GDP: $3.35 trillion
Odds: 14-1 **Players to watch:** Bastian Schweinsteiger is a multitooled midfielder with a surname meaning "Pigclimber"; young midfielder Mesut Özil is a visionary; goalkeeper Manuel Neuer replaces Robert Enke, who committed suicide seven months ago. **The bottom line:** With Captain Michael Ballack lost to injury, the squad is thin, especially on defense. Thanks to World Wars I and II, they have more rivalries than all other teams combined: Every game is a grudge match. Their unexpected run to the semifinal in 2006 triggered a national birthrate boom of 10 to 15 percent.

The Scandalmongers

These teams' made-for-tabloid antics could trump their play in South Africa.

England
GDP: $2.18 trillion (U.K.) **Odds:** 6-1 **Players to watch:** Wayne Rooney, the furious attacking force; gossip-rag-starring left-back Ashley Cole; and, lacking any reliable option, whoever starts in goal. **The bottom line:** They have drawn as much attention as the recent parliamentary election with a slew of sex scandals, key injuries, and an entourage of fame-craving wives and girlfriends ("WAGs"). British fans, who injected more than $2 billion into the retail sector during the last Cup, wonder whether Italian manager Fabio Capello—who earns nearly $11 million annually—can save their team.

France
GDP: $2.68 trillion **Odds:** 16-1
Players to watch: Winger Franck Ribéry, midfielder Yoann Gourcuff, and defender



If Argentina, and striker Gonzalo Higuaín, win it all, their coach has promised to run naked through Buenos Aires

The master of the dark art of the flop



Cristiano Ronaldo
National team: Portugal
Club: Real Madrid
The sport's greatest show pony, who takes in about $30 million a year all told, possesses power and seriously fast feet

RONALDO: MIKE HEWITT/GETTY IMAGES; HIGUAÍN: THOMAS LOHNES/AFP/GETTY IMAGES

Etc. The World Cup

No European team has ever won a World Cup hosted outside the Continent



Patrice Évra. **The bottom line:** The team qualified courtesy of a blatant handball that appalled even die-hard fans. Morale was pummeled further when three key team members became ensnared in an underage prostitution scandal so shocking it actually offended French sensibilities.

For Admirers of Nutjob Leadership

These coaches will make their countries' World Cup experience a thrill ride.

Argentina
GDP: $310 billion **Odds:** 6-1
Players to watch: Lionel Messi, the world's highest-paid player; attacking spearhead Gonzalo Higuaín; and the young winger Angel Di Maria. **The bottom line:** Diego Maradona, one of the greatest players in the game's history, appeared out of his depth as coach during qualifying. The team waited until its last game to scrape in to the tournament, leading Maradona to promise he will charge naked through the streets of Buenos Aires if they win the Cup.

Japan
GDP: $5.07 trillion **Odds:** 250-1
Players to watch: Iconic free-kick specialist Shunsuke Nakamura and midfielder Yasuhito Endo. **The bottom line:** Coach Takeshi Okada declared that his team would reach the semifinals, but he may be the only one who believes it.

Slovakia
GDP: $88.2 billion **Odds:** 250-1
Players to watch: Marek "The Phantom" Hamšík is a highly rated playmaker; coach's son Vladimir Weiss Jr. is a tiny wonder. **The bottom line:** Coach Vladimir Weiss sobbingly told his young team he loved them after they qualified.

Despite limited resources, their collective spirit may be their top asset.

Style over Substance

Adidas expects to top a reported $1.8 billion in sales courtesy of the tournament. After Nike leaped into the soccer fray, in 1994, and Puma focused on the fast-growing African game, the three brands have used the World Cup as a fierce marketing battleground. The cut of these teams' jib commands your support.

Cameroon
GDP: $22.2 billion **Odds:** 100-1
Players to watch: Striker Samuel Eto'o–if he decides to play–and midfield dynamo Alexandre Song. **The bottom line:** Despite their handsome green V-neck jerseys with the team's motif, the Indomitable Lion, artfully layered across one shoulder, they'll go as far as Eto'o takes them. The country received an unexpected payday after FIFA discovered that the "official anthem of the 2010 World Cup," Shakira's *Waka Waka,* was a reinterpretation of a 1986 hit by the Cameroonian military band Zangalewa.

Holland
GDP: $795 billion **Odds:** 10-1
Players to watch: Wesley Sneijder, Arjen Robben, and Robin Van Persie are an arrogantly free-flowing–and injury-prone–offensive trio. **The bottom line:**



Team uniforms are now marketing billboards. Adidas plans to make $1.8 billion in sales from the Cup

Kaká will try to redeem himself after a disappointing club season



Kaká
National team: Brazil
Club: Real Madrid
Although he has struggled with an injured groin, the $25 million-per-year player is the creative cog in Brazil's counterattack



Iker Casillas
National team: Spain
Club: Real Madrid
Agile, focused, and instinctive, he is the finest goalkeeper in the world today

Algeria, Slovenia ▶ **GROUP D:** *Germany, Australia, Serbia, Ghana* ▶ **GROUP E:** *Netherlands, Denmark, Japan, Cameroon* ▶ **GROUP F:**

Their brilliant orange uniforms harken back to the days of Johan Cruyff's 1974 Total Football team. If they remain healthy, the Oranje–who had a perfect record in qualifying–may have a chance to reclaim similar glory.

South Korea
GDP: $833 billion **Odds:** 200-1 **Players to watch:** The tireless optimism of midfielder Park Ji-Sung, set-play majesty of Park Chu Young, and midfield invention of Chung-Yong Lee. **The bottom line:** Their blazing red uniforms–which perfectly set off the classically designed badge of the Korean Soccer Federation–cannot save a team that is energetic but lacking in quality. The exception is Ji-Sung, who is regaled by Manchester United fans with the cheer: "He shoots, he scores, he eats Labradors." Analysts hope against a repeat of the 2002 Cup when Singapore's stock market plunged due to a lack of buying interest.

The Fan Factor

It's hard not to become swept up in the infectious fervor and curious behavior surrounding these teams' fans.

Denmark:
GDP: $309 billion **Odds:** 125-1 **Players to watch:** Erratic striker Nicklas Bendtner and defender Daniel Agger. **The bottom line:** The famously ebullient Danish fans may have their style cramped by the ongoing strike at the Carlsberg brewery.

Mexico
GDP: $875 billion **Odds:** 80-1 **Players to watch:** The impish Giovani dos Santos is a spark plug, while goalie Guillermo Ochoa is effective. **The bottom line:** Although the team rarely gets past the Round of 16, Mexico's rabid fan base is a legendary unifying force.



Soccer City in Johannesburg is designed in part to resemble an African cooking pot

Nigeria
GDP: $173 billion **Odds:** 100-1 **Players to watch:** Powerful forward Obafemi Martins and penetrating midfielder John Mikel Obi. **The bottom line:** The government even built an exhibition that follows the team around showcasing investment in the oil-rich nation's resources.

The Wounded Warriors

To back these teams is to root for the supporting cast–and a miracle.

Ghana
GDP: $15.5 billion **Odds:** 80-1 **Player to watch:** Kevin-Prince Boateng knocked Germany's star Michael Ballack out of the tournament with a vicious tackle in England's FA Cup Final. The Ghana-Germany clash on June 23 promises to be a brawl. **The bottom line:** The "Brazilians of Africa" are rocked by the loss of defensive midfielder Michael Essien to a knee injury.

Paraguay
GDP: $14.7 billion **Odds:** 80-1 **Players to watch:** Gallant Roque Santa Cruz and clinical Oscar Cardozo must bring their scoring boots. **The bottom line:** Any real chance to win ended when star striker Salvador Cabañas was shot in the head in a Mexico City nightspot.

Switzerland:
GDP: $495 billion **Odds:** 200-1 **Players to watch:** Attacker Blaise Nkufo and the midfielder Tranquillo Barnetta. **The bottom line:** Record goal scorer Alexander Frei is racing to regain form after shattering his arm in April.

The Spoilers

The soccer world has become flat: Any of the following could make life very difficult for their opponents.

Chile
GDP: $162 billion **Odds:**

Maicon is named after Michael Douglas (seriously)

Shortly after the tournament, Rooney is expected to sign a new contract worth approximately $160,000 per week or more



Franck Ribéry
National team: France
Club: Bayern Munich
Although mired in a sex scandal off the field, on the pitch his pace and relentlessness can change a match



Maicon
National team: Brazil
Club: Inter Milan
The skilled right-back and one-name wonder loves to maraud the flank and cannon the ball goalward



Wayne Rooney
National team: England
Club: Manchester United
He's been plagued by injuries, but this warrior will chase the ball into every corner of the field

Paraguay, Italy, New Zealand, Slovakia ▶ **GROUP G:** *Brazil, North Korea, Ivory Coast, Portugal* ▶ **GROUP H:** *Spain, Switzerland, Honduras, Chile*

TROPHY: SHUJI KAJIYAMA/AP; KAKA': FELIPE DANA/GETY IMAGES; CASILLAS: MICHAEL STEELE/GETTY IMAGES; MORAS/JO HONG: SEBASTIAN DERUNGS/GETTY IMAGES; STADIUM: GIULIANO BEVILACQUA/UMA; RIBE'RY: FRANCK FIFE/GETTY IMAGES; MAICON: GLYN KIRK/GETTY IMAGES; ROONEY: SHAUN BOTTERILL/GETTY IMAGES. FOLLOWING PAGE: DONOVAN: IAN WALTON/GETTY IMAGES; MESSI: AFA/LATINCONTENT/GETTY IMAGES; XAVI: DENIS DOYLE/GETTY IMAGES

AMERICA
A PORTFOLIO OF IDEAS

Are social networks pulling the strings of our economic decision makers?

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James H. Fowler
Professor
University of California, San Diego



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Etc. The World Cup



Landon Donovan hopes to advance the American side out of their opening group

66-1 **Players to watch:** Plump striker Humberto Suazo will be joined by Alexis Sánchez, a prodigy known as "El Niño Maravilla." **The bottom line:** Coach Marcelo Bielsa has molded a squad keen to prove Goldman Sachs' assessment that there is no correlation between equity markets and Cup performance.

Serbia
GDP: $42.9 billion **Odds:** 50-1
Players to watch: Coveted defenders Nemanja Vidic and Neven Subotić. **The bottom line:** The team's top players are aware that a strong World Cup showing may well lead to a lucrative money transfer after the tournament.

Slovenia
GDP: $49.2 billion **Odds:** 250-1
Players to watch: Midfielder Robert Koren is the puppet master; striker Milivoje Novakovic is a skillful beanpole. **The bottom line:** Despite a population about one-fifth that of Moscow's, Slovenia stunned Russia to qualify.

The Redeemers

Aligning yourself with these teams may be the righteous thing to do.

Algeria
GDP: $141 billion **Odds:** 400-1
Player to watch: Midfielder Mourad Meghni, known as le Petit Zidane, after the French legend. **The bottom line:** Still smarting over their controversial elimination by West Germany and Austria in 1982, this squad must not be underestimated by the U.S.

Australia
GDP: $997 billion **Odds:** 125-1
Players to watch: Tim Cahill is one of the greatest headers of the ball, and striker Joshua Kennedy is known as "The Messiah." **The bottom line:** They harbor extra motivation owing to their exit at the last World Cup, when opponent Italy was awarded a controversial penalty in the game's dying seconds.

Honduras
GDP: $14.3 billion **Odds:** 750-1
Players to watch: Forceful midfielder Wilson Palacios and defender Maynor Figueroa. **The bottom line:** Their qualification brought joy to streets that had recently witnessed a coup. This team could surprise.

Ivory Coast
GDP: $22.5 billion **Odds:** 33-1
Players to watch: Chelsea's one-man forward line, Didier Drogba, and Barcelona ball handler Yaya Toure in midfield. **The bottom line:** The host continent's top team is haunted by the death of numerous fans crushed in a 2009 stadium stampede.

Roger Bennett is co-author of The ESPN World Cup Companion.

DATA: IMF GROSS DOMESTIC PRODUCT REPORT FOR 2009; ODDS: WILLIAM HILL, AS OF JUNE 1

Xavi will play through the pain of a calf-muscle tear



Lionel Messi
National team: Argentina
Club: Barcelona
FIFA's World Player of the Year makes an estimated $44 million per year dominating games.



Xavi
National team: Spain
Club: Barcelona
A tiny midfield metronome, he can clinically dismantle opponents with his vision and precision passing

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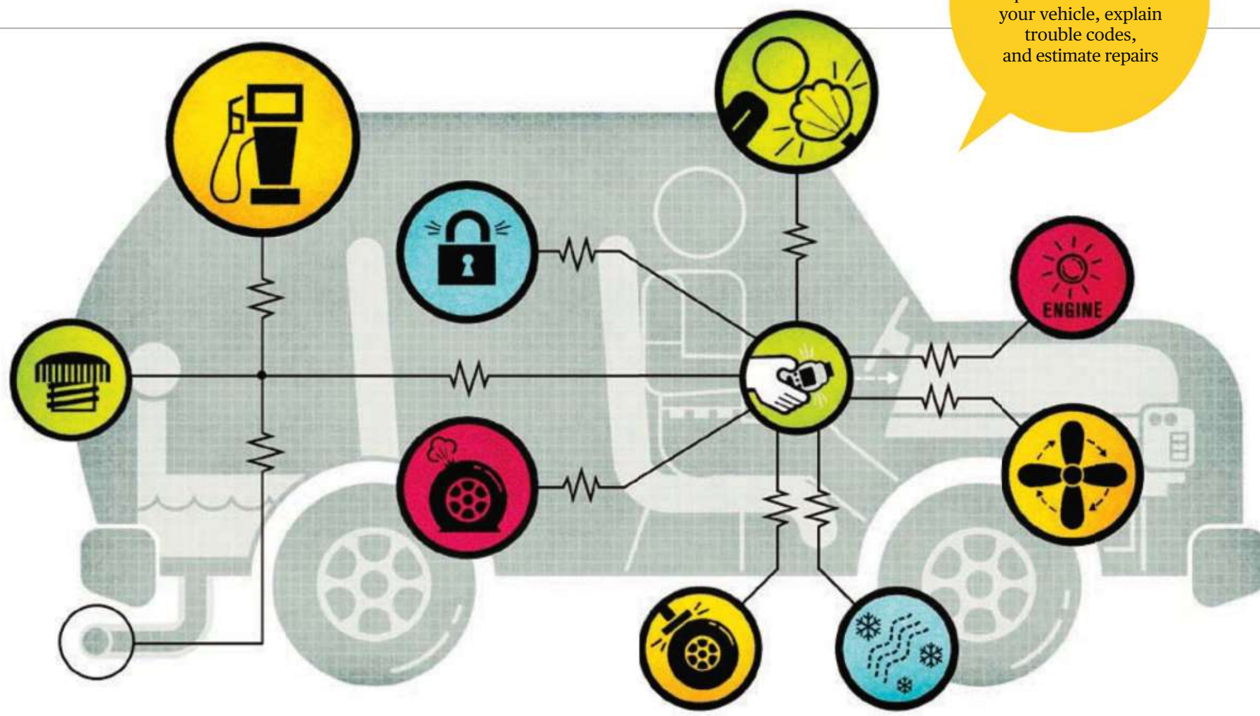
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For $98.99, CarMD will provide a quick rundown on your vehicle, explain trouble codes, and estimate repairs



Heal Your Wheels

Plugging in the CarMD will keep you in tune with your auto

By Rich Jaroslovsky

I just delivered some bad news to a colleague about a cherished family member: His wife's 1999 Honda Accord is looking at a $1,000 repair bill. The diagnosis comes courtesy–if that's the right word–of CarMD, an easy-to-use device that taps into your car's onboard computer system, then lets you upload the results to a website that provides an almost-plain-English description of what's wrong. It also provides an estimate of how much the work will cost.

The CarMD gadget, which retails for $98.99, has been around a couple years, but it has recently undergone some significant enhancements. It now has support for Macs as well as Windows PCs, coverage for antilock braking systems and air bags, and extra-cost access to the technical bulletins that carmakers provide dealers and mechanics.

The CarMD is about the size of a cell phone, with two buttons, a display screen, and green, yellow, and red LEDs. At one end is a plug that fits the diagnostic-computer port in the passenger compartment of every car built since 1996. The CarMD website, where you enter your auto's year, make, and model, displays a diagram showing the location of the computer connection. Once the device is plugged into the port and the ignition is on, four beeps will indicate that the computer's contents have been downloaded.

About the size of a cell phone, the newly improved CarMD provides technical service bulletins and diagnoses what's ailing your vehicle



Those LEDs give you an early indication. If green, all's well. If yellow or, especially, red, hold on to your wallet. Blinking lights and obscure codes on the screen tell you only so much. It's the simplicity of CarMD's Web-based services–explaining the codes and estimating costs–that really provides the value, even if taking advantage of them can be a little cumbersome: You'll need to install special software on your computer to get the data from device to Internet, and you can't use one CarMD with more than three vehicles.

My year-and-a-half-old ride got a clean bill of health. But CarMD diagnosed my co-worker's Accord as having a faulty pollution control system–the Honda won't pass its next emissions test, the site reported–and suggested several potential fixes.

Eventually, the company hopes to assemble a network of mechanics who'll honor the software's estimates. For now, though, you'll have to settle for feeling a little more knowledgeable–even empowered, perhaps–when you roll into the garage with the dashboard light glowing. B

ILLUSTRATION BY HEADCASE DESIGN; CAR MD: DANIEL ACKER/BLOOMBERG

Etc. One True Thing

Sunglasses

Shades that add style points to your summer look

The Men's Want: Cool that doesn't try too hard. They should make an impression on the walk into work and stay put through 18 holes. And you don't want to see them on everyone else.

The Get: Paul Smith's PS509 shades ($400 at Paul Smith stores) are handcrafted in limited release, so your co-workers won't have them. The classic shape is enlarged for extra panache, and the contoured bridge and arms mean they won't fall off.

The Women's Want: Fashionable, flattering, and sleek enough to match a business suit. The frame should be of-the-moment but not trendy. Please, no big branding or goggle-size frames.

The Get: Modo for Jason Wu's Mia ($275 at modo-shop.com), a retro-style frame modernized by beveled edges and a smoky gray hue. The slightly oversized shape looks good on faces both slim and round, and double-gradient lenses work well in bright and low light. Ⓑ —*Stephen Treffinger and Desiree Marr*



Rising 27-year-old fashion star Jason Wu is best known for Michelle Obama's inauguration gown

Ebay sells a pair of men's sunglasses every minute and a half

SHADES OF FAME

Sunglass-wearing icons' favorite frames.



Anna Wintour
Giant Chanel shades (like No. 5076H, $340 at Cohen's Fashion Optical) shield the *Vogue* editor from flashbulbs



Richard Branson
For yachting and flying, the U.K. billionaire dons Oakley's sporty, carbon-colored Juliet model ($350 at oakley.com)



Oprah Winfrey
Fendi's glamorous No. 413 sunglasses ($250 at popularglasses.com) supply the requisite mogul bling



Elton John
The music legend traded in his big '70s styles for smaller round ones like Armani's 646/S ($200 at unitedshades.com)

PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATIONS BY JAMESON SIMPSON

Invest in



Riding the Real Estate Roller Coaster

In the recovery, Green Street's Mike Kirby bets on Avalon Bay, Simon Property, and Starwood

A year ago, the commercial real estate market was very ugly. Property values had dropped 40 percent and it looked like it was going to be very, very difficult to work our way out of the mess. There was a looming maturity of mortgages written between 2005 and 2007, the peak bubble years. A lot of these mortgages had five-year maturity triggers and were coming due. Very often all of the equity was wiped out, and mortgage holders were going to take a hit. It had elements of the housing mess, where it looked like no new mortgage financing would be available.

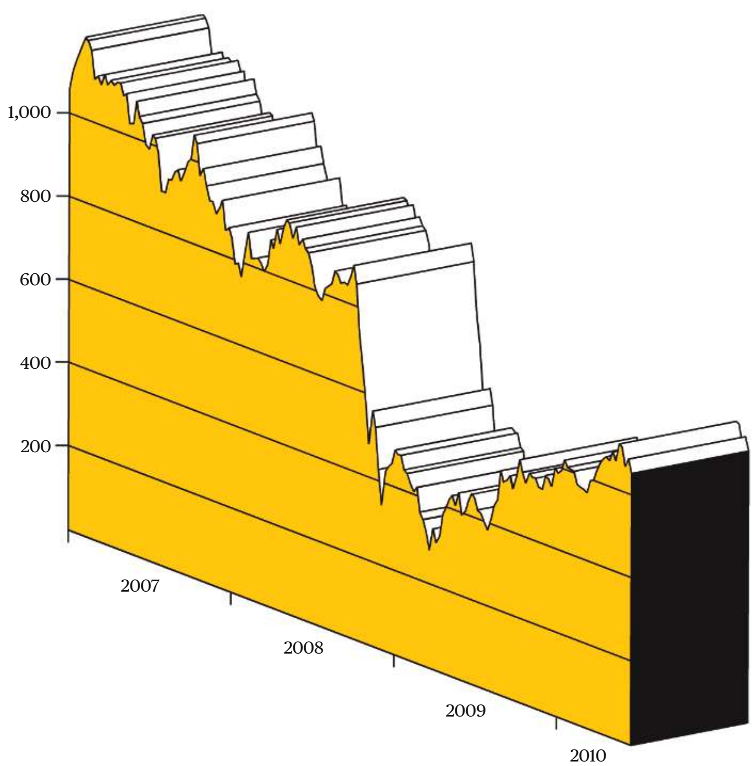
Now it's pretty easy to see that the level of distress will be fairly low. Commercial real estate had been referred to as the next shoe to drop for the economy. It's just not going to be that kind of issue. Property prices are up 20 percent from their trough, and that has done a lot to mitigate the problem. Financing markets are working a lot better.

Real estate investment trusts are up well over 100 percent off their March 2009 lows, to the point where we believe they are priced on the rich side of a fair range. We are not willing to call them overpriced just yet, though. When I compare what real estate and REITs can deliver over the long haul to how corporate bonds are priced, REITs look pretty fairly valued. The average yield is 3.5 percent.

When I look at REITs vs. stocks, though, they don't look attractive. REITs have been trading at a price-earnings ratio of about 20, while the Standard & Poor's 500-stock index has traded at a p-e closer to 14. These numbers are usually a lot closer to each other.

Historically, this has been a signal to load up on stocks other than REITs. We are not pounding the table on any REIT sector. Our list of buys is stock-specific. Avalon Bay—which owns high-quality apartments in good coastal markets like New York and the Bay Area—is one of the best apartment companies in the country. It has been helped by the decline in homeownership. I think people are going to be very wary of the old American dream as it was once defined. If the homeownership ratio stays at or below where it is—a good bet—that creates a good set of dynamics. Job growth and declining homeownership drive apartment demand. I assume we're turning a corner on job growth, so you may have both dynamics working.

MSCI U.S. REIT INDEX — **REITs are up 130% from their March 2009 lows**



DATA: BLOOMBERG

Commercial real estate prices are up 20 percent from their trough

Among mall REITs, we have a buy on Simon Property Group. It is the 500-pound gorilla in malls. Like Avalon, it's the crème de la crème of its sector, and it isn't much more richly valued than its peers. I can buy Simon at basically the same type of pricing as an average mall REIT.

In hotels our biggest name is Starwood. It benefits from the fact that the franchising model is doing quite well—if only because we are seeing an awful lot of brand growth in foreign markets, particularly Asia, Turkey, and Brazil. —*As told to Lewis Braham*

The Stats: Mike Kirby is chairman and director of research at Green Street Advisors, a real estate research firm based in Newport Beach, Calif. Kirby co-founded Green Street in 1985. The performance of Green Street's buy recommendations has been an annualized 25.7 percent from February 1993 to May 2010.

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According to the author, the Internet is a powerful impetus for groupthink

ILLUSTRATION BY DEVON DOSS

Albert Einstein Never Tweeted

The Net is revolutionizing how we obtain information, but at what cost? *By Peter Burrows*

Have you ever worried about your annoying need to go to Google because you couldn't remember something? Have you wondered about your constant desire to check your e-mail, Twitter account, or favorite blog rather than read a great book or enjoy a beautiful day?

If you haven't yet, you will after reading Nicholas Carr's *The Shallows: What the Internet Is Doing to Our Brains*. The book, an expansion of his 2008 article in *The Atlantic*, makes a compelling case that such fears are justified. Our constant inundation with electronic stimuli, he argues, is actually changing the brains's wiring. As we choose among all those enticing Web links, process blinking online ads, or get our Facebook fix, we are also sapping our neurological ability to remember facts or pay attention long enough to fully digest what we read. Those who didn't experience life before Google—or have already forgotten it—may even have a harder time generating the same empathy or interest in their fellow man.

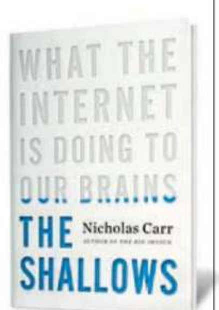
If that sounds like an apocalyptic anti-technology rant, give Carr a chance. A prolific blogger, tech pundit, and author, he cites enough academic research in *The Shallows* to give anyone pause about society's full embrace of the Internet as an unadulterated force for progress. One study he refers to shows that people watching a CNN news spot retained far more information without the headlines scrolling by at the bottom of the screen. Another shows that the more links there are in an article, the lower the comprehension of the reader. A third indicates that our brains automatically overvalue information simply because it's new. Carr quotes neuroscientist Michael Merzenich, who says we are "training our brains to pay attention to the crap." Perhaps most scary, the Brain & Creativity Institute at the University of Southern California found that while the brain's response to physical pain shows up immediately on neurological scans, people must pay attention for a longer time before their brain shows telltale signs of caring about someone else's pain. Carr's takeaway: "The more distracted we become, the less able we are to experience the subtlest, most distinctly human forms of empathy, compassion, and emotion."

Carr lays out, in engaging, accessible prose, the

i

The Shallows: What the Internet Is Doing to Our Brains

By Nicholas Carr
NORTON;
276 pp; $26.95



science that may explain these results. One key is the brain's shortage of so-called working memory, the mechanism that sifts through the avalanche of real-time information that swamps our senses and selects the important bits for incorporation into our long-term memories and insights. It turns out there's only room for two to four items at a time in this neural way station—not nearly enough to keep up with a website packed with links, videos, and RSS feeds. While the mind of the book reader considers what's important at its own pace, the Netizen's brain has to choose much more quickly and haphazardly. As a result, our ability to make the most of the input is diminished, and we become "mindless" consumers of data. This may also explain why sometimes it becomes harder to concentrate the longer you spend browsing the Web.

Unsurprisingly, many of the Internet companies that we have come to live by don't fare well under Carr's gaze. While Twitter is a powerful tool for good in the hands of protesters in despotic lands, he writes that its very motto—"Discover what's happening right now"—might as well be an advertisement for a neurological heroin that trains your brain to be even more distracted. And while Google's geeky founders may truly believe in their stated objective "to organize the world's information and make it universally accessible and useful," Carr argues that Google is, "quite literally, in the business of distraction." After all, the more links you click on, the more money the company makes.

While Carr believes the Internet is a revolutionary tool for finding information, he also suggests that it may be a dangerously powerful impetus to groupthink. As evidence, he suggests a study by the National Institute of Neurological Disorders & Stroke suggesting that multitasking makes people "more likely to rely on conventional ideas and solutions rather than challenging them with original lines of thought." And a University of Chicago study showed that academic papers began citing fewer sources, not more, after publications began going online.

Taken to its extreme, Carr's arguments suggest the Internet Age is less likely than previous eras to produce Einsteins, Edisons, and Tolstoys. Such extraordinary people were not forever distracted from their work by 140-character bursts or incessant YouTube videos. Nor were they tempted to throw their semi-finished work out on the Web, safe in the knowledge that they could easily update it later. Indeed, Carr argues, they owe their mastery, in part, to the difficulty of achieving it. Absorbing entire hard-to-find texts—rather than forever Googling random facts—may have been a key to their development.

Even though the book is only now hitting shelves, many Internet devotees will undoubtedly take its thesis as pure quackery. Presented with Carr's arguments, Theodore Gray, co-founder of search engine provider Wolfram Research, told me: "It's very easy to look back and point to Voltaire and Einstein and great literature and figure we're all just ignorant fools compared to the past. There are a lot of people who think deeply. Thanks to the Internet, they are able to think more deeply about more things." Ray Kurzweill, an author, entrepreneur, and futurist, also thinks Carr's argument is bunk. "We have many more people engaged in thinking and writing about issues than ever before. There are 200 million blogs in China alone—despite the censorship."

These critics certainly have a point. The best of us will benefit hugely from the Internet. As with any form of new technology, how you use it dictates its usefulness. Regardless, Carr seems to understand that his arguments will not slow down the Netification of society. Nowhere in the book does he bother to offer any actual prescriptions for the problem he sees.

Carr, however, fears the Internet will actually cause the brain to take its first step backward in centuries. Our cave-dwelling ancestors were consumed with immediate concerns—run from the lion, kill the mastodon, get out of the rain. Then various media provided an abstract way of thinking about the world. The map helped us explore other lands, establish trading routes, and draw up battle plans. The clock and calendar raised our productivity by enabling us to organize our time. Then came writing. Over time, especially after Gutenberg, the book turbocharged our ability to think conceptually and deeply about the world around us.

Americans now spend 8.5 hours a day frenetically interacting with their PCs, TVs, or, increasingly, the smartphones that follow them everywhere. In the process, writes Carr, we are reverting to our roots as data processors. "What we're experiencing is, in a metaphorical sense, a reversal of the early trajectory of civilization: We are evolving from being cultivators of personal knowledge to being hunters and gatherers in the electronic data forest."

Whether Carr is right or not isn't really the point. Other than obvious problems such as child porn and online fraud, there's been very little hesitation or contemplation about the side effects of the Net as we race to take advantage of its bounties. At the very least, Carr will have done an important service by making people think just a bit differently the next time they find themselves Twittering their hours away. It may be more than a waste of time. It may also waste our brains. Ⓑ

8.5
Number of hours per day Americans spend interacting with a PC, TV, or smartphone

30-40
Number of times per hour that American office workers check their e-mail

2,272
Average number of monthly texts sent and received by American teenagers, fourth quarter 2008

DATA: BALL STATE UNIVERSITY; *THE SHALLOWS*; NIELSEN

Google is "in the business of distraction," while Twitter might be neurological heroin

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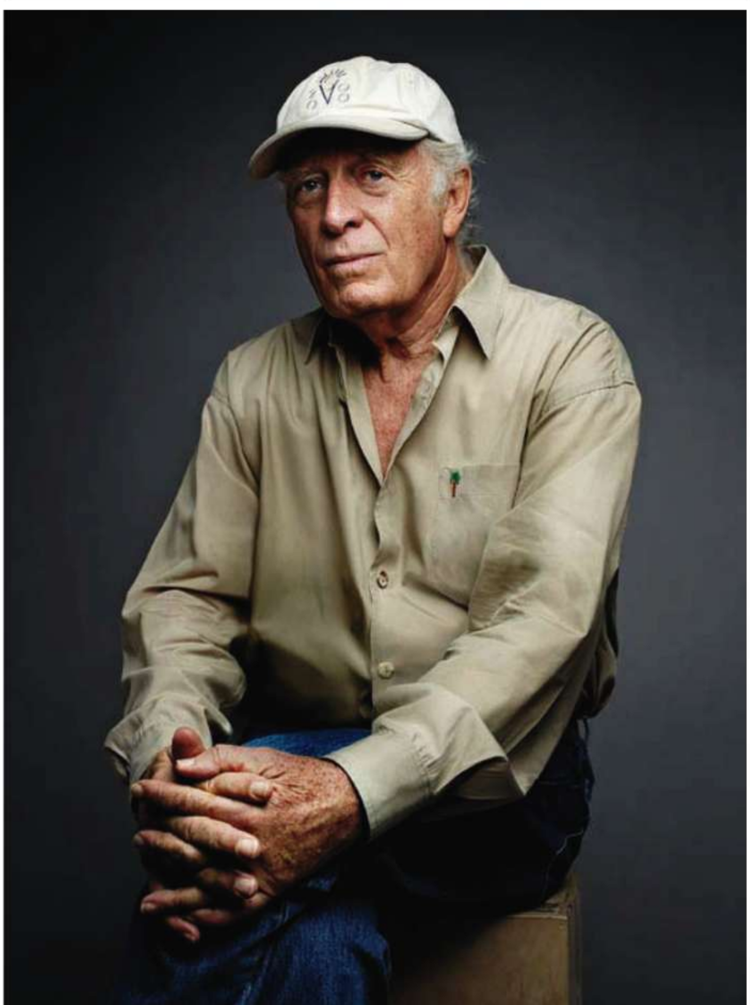
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Etc. Hard Choices

Chris Blackwell

"Marley was known as a rebel.... I fronted him some 4,000 pounds–a fair bit then–which effectively said, 'If you want to screw me, screw me.' "

The Island Records founder–and the man who discovered U2–remembers making a bet on a controversial reggae singer



I grew up in Jamaica, and when the country became independent in 1962, I went to England to sell the records I had made back home [to the Jamaican community].

I learned to sign artists not so much by listening to their music as through evaluating them as people. Intelligence is very important if you're going to have a long-term career. When you do have a hit, you go from a bum to a hero in a second, and you've got to be savvy enough to guide yourself through the maze.

I didn't get U2's music–the sound was too trebly for me–but I signed them because I loved them as people. I talked to Richard Branson at a party and liked him so much that I helped him start Virgin Records. I met Cat Stevens when he was trying to do a musical on the Russian Revolution, and even though I wasn't interested in the musical, I loved his passion. I told him to rustle up his hair, look a little crazed, and tell his label that he wanted to do his next record with the London Philharmonic. He was released from his contract and came to work with me.

In 1972, I got a lot of criticism for giving Bob Marley money–without a contract–to record an album. Everyone said I was crazy. Marley was known as a rebel; he had a reputation for being difficult, and when I met him, he was totally broke. I fronted him some 4,000 pounds–a fair bit then–which effectively said, "If you want to screw me, screw me." There was something about him, though, and I think he did trust me. But it helped that I trusted him first.

Too often, record companies treat artists like they're slippery. Marley just wanted to be treated fairly. The Jamaican music business was corrupt, with artists getting five or ten pounds to record and no royalties. Bob Marley and his partners came in like lions and didn't trust anyone. I knew I had to show them I was an ally. Two or three months afterwards, I went to meet with them and we signed a contract.

Bob turned out to be brilliantly talented. He died just as he was starting to take off. I was crushed that he went so soon. B —*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK


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